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90-1954

Supreme Court, U.S.
FILED
JUN 17 1991
OFFICE OF THE CLERK

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

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2 TUDOR CITY
PLACE ASSOCIATES
and 2 TUDOR GARDEN
PARKING CORPORATION,

Petitioners,

-against-

2 TUDOR CITY
TENANTS CORPORATION,
KINNEY SYSTEMS, INC. and
AMERICAN SAVINGS BANK,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

I. Whether the decision of the Second Circuit below has converted the Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §§3601 et seq. ("the Act") into an instrument of abuse by construing its provisions, in defiance of Congressional intent, to allow unscrupulous tenants to cheat real estate developers by terminating, without cause or compensation, economically desirable, long term financial leases.

II. Whether contracts for "operation, maintenance and management" under Section

3607 of the Act include financial leases that do not obligate a developer-lessee to provide services of any sort to a tenants association in its capacity as lessor.

III. Whether Section 3607 of the Act, which was designed to protect tenants against self-dealing, should be construed to allow tenants to set aside, without cause or compensation, a lease utterly untainted by any form of self-dealing.

IV. Whether Section 3607 of the Act deprives developers of their property under the Due Process and Takings Clauses of the Fifth Amendment.

PARTIES TO THE PROCEEDINGS IN THE COURT WHERE JUDGMENT IS SOUGHT TO BE REVIEWED

The parties in the court below were 2 Tudor Place Associates and 2 Tudor Parking Corp.,* plaintiffs-appellees; and 2 Tudor City Tenants Corp., Kinney Systems, Inc., and American Savings Bank, defendants-appellants.

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* Pursuant to Rule 29.1 of the Rules of the Supreme Court, petitioner 2 Tudor Parking Corp. states that it has no parent company and no subsidiaries.

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The opinion of the United States Court of Appeals for the Second Circuit is reported at 924 F.2d 1247, and is set forth in the appendix at A-1. The opinion of the United States District Court for the Southern District of New York is unreported and is reproduced in the appendix at A-17.

JURISDICTION OF THIS COURT

The judgment of the Court of Appeals for the Second Circuit was filed on February 5, 1991. (A-40) The petition for rehearing was denied by order entered on March 21, 1991. (A-42) This Court has jurisdiction to review the judgment of the Court of Appeals pursuant to 28 U.S.C. §1254.

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED

The Fifth Amendment to the Constitution provides, in pertinent part:

> nor shall any person . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

The Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §3607, provides:

> **§3607 - Termination of self-dealing contracts**
>
> **Operation, maintenance, and management contracts; penalty**
>
> (a) Any contract or portion thereof which is entered into after October 8, 1980, and which -
>
> (1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property

serving the condominium or cooperative unit owners in such project;

(2) is between such unit owners or such association and the developer or an affiliate of the developer;

(3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and

(4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,

may be terminated without penalty by such unit owners or such association.

Time of termination

(b) Any termination under this section may occur only during the two-year period beginning on the date on which --

(1) special developer control over the association is terminated; or

(2) the developer owns 25 per centum or less of the units in the conversion project,

whichever occurs first.

Vote of owners of units

> (c) A termination under this section shall be by a vote of owners of not less than two-thirds of the units other than the units owned by the developer or an affiliate of the developer.

Effective date of termination

> (d) Following the unit owners' vote, the termination shall be effective ninety days after hand delivering notice or mailing notice by prepaid United States mail to the parties to the contract.

The Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §3608, provides:

> **Judicial determinations respecting unconscionable leases**
>
> **Lease characteristics; authorization by unit owners; conditions precedent to action**
>
> (a) Cooperative and condominium unit owners through the unit owners' association may bring an action seeking a judicial determination that a lease or leases, or portions thereof, were unconscionable at the time they were made. An action may be brought under this section if each such lease has all of the following characteristics:
>
> (1) it was made in connection with a cooperative or condominium project;

(2) it was entered into while the cooperative or condominium owners' association was controlled by the developer either through special developer control or because the developer held a majority of the votes in the owners' association;

(3) it had to be accepted or ratified by purchasers or though the unit owners' association as a condition of purchase or a unit in the cooperative or condominium project;

(4) it is for a period of more than twenty-one years or is for a period of less than twenty-one years but contains automatic renewal provisions for a period of more than twenty-one years;

(5) it contains an automatic rent increase clause; and

(6) it was entered into prior to June 4, 1975.

Such action must be authorized by the cooperative or condominium unit owners through a vote of not less than two-thirds of the owners of the units other than units owned by the developer or an affiliate by the developer, and may be brought by the cooperative or condominium unit owners through the unit owners' association. Prior to instituting such action, the cooperative or condominium unit owners must, through a vote of not less than two-thirds of the owners of the units other than units owned by the developer or an affiliate of the developer, agree to enter into negotiation with the

lessor and must seek through such negotiation to eliminate or modify any lease terms that are alleged to be unconscionable; if an agreement is not reached in ninety days from the date on which the authorizing vote was taken, the unit owners may authorize an action after following the procedure specified in the preceding sentence.

Presumption of unconscionability; rebuttal

(b) A rebuttable presumption of unconscionability exists if it is established that, in addition to the characteristics set forth in subsection (a) of this section, the lease --

(1) creates a lien subjecting any unit to foreclosure for failure to make payments;

(2) contains provisions requiring either the cooperative or condominium unit owners or the cooperative or condominium association as lessees to assume all or substantially all obligations and liabilities associated with the maintenance, management and use of the lease property, in addition to the obligation to make lease payments;

(3) contains an automatic rent increase clause without establishing a specific maximum lease payment; and

(4) requires an annual rental which exceeds 25 percentum of the appraised value of the leased property as improved: Provided,

That, for purposes of this paragraph "annual rental" means the amount due during the first twelve months of the lease for all units, regardless of whether such units were occupied or sold during that period, and "appraised value" means the appraised value placed upon the leased property the first tax year after the sale of a unit in the condominium or after the sale of a membership or share interest in the cooperative association to a party who is not an affiliate of the developer.

Once the rebuttal presumption is established, the court, in making its finding, shall consider the lease or portion of the lease to be unconscionable unless proven otherwise by the preponderance of the evidence to the contrary.

Presentation of evidence after finding of unconscionability

(c) Whenever it is claimed, or appears to the court, that a lease or any portion thereof is, or may have been, unconscionable at the time it was made, the parties shall be afforded a reasonable opportunity to present evidence at least as to --

(1) the commercial setting of the negotiations;

(2) whether a party has knowingly taken advantage of the inability of the other party reasonably to protect his interests;

(3) the effect and purpose of the

lease or portion thereof, including its relationship to other contracts between the association, the unit owners and the developer or an affiliate of the developer; and

(4) the disparity between the amount charged under the lease and the value of the real estate subject to the lease measured by the price at which similar real estate was readily obtainable in similar transactions.

Remedial relief; matters considered; attorney's fees

(d) Upon finding that any lease, or portion thereof, is unconscionable, the court shall exercise its authority to grant remedial relief as necessary to avoid an unconscionable result, taking into consideration the economic value of the lease. Such relief may include, but shall not be limited to rescission, reformation, restitution, the award of damages and reasonable attorney fees and court costs. A defendant may recover reasonable attorneys' fees if the court determines that the cause of action filed by the plaintiff is frivolous, malicious, or lacking in substantial merit.

Actions allowed after termination of special developer control

(e) Nothing in this section may be construed to authorize the bringing of an action by cooperative and condominium unit owners' association, seeking a judicial determination that a lease or leases, or portions thereof,

are unconscionable, where such unit owners or a unit owners' association representing them has, after the termination of special developer control, reached an agreement with a holder of such lease or leases which either --

(1) sets forth the terms and conditions under which such lease or leases is or shall be purchased by such unit owners or associations; or

(2) reforms any clause in the lease which contained an automatic rent increase clause, unless such agreement was entered into when the leaseholder or his affiliate held a majority of the votes in the owners' association.

STATEMENT OF THE CASE

This case raises important questions about the statutory construction of a federal statute that has widespread ramifications for the conversion of rental properties to condominiums and cooperatives. The statute in question, the Condominium and Cooperative Abuse Relief Act of 1980 (the "Act"), is by any measure an ineptly drawn statute whose substantive provisions are poorly integrated, and whose overall design bears only imperfect relationship to the set of evils that Congress sought to address. But this Court must seek to give effect to the language, structure, context and purpose of poorly crafted statutes, just as it does for well-drafted ones. Where all the loose ends cannot be tied neatly together, the judicial task is to give effect to the main purpose

of the statute by minimizing statutory oversights and errors.

In undertaking this task there are a number of general guidelines that can help to smooth the way. It has long been a rule of statutory construction that statutes designed to prevent the occurrence of fraud and abuse should not be made into an instrument for their creation. What was said of the statute of frauds is equally applicable here. "The purpose and intent of the statute of frauds is to prevent fraud, and the courts will, so far as possible, refuse to permit it to be made the shield for fraud." Bader v. Hiscox, 188 Iowa 986, 174 N.W. 565 (1919). All the provisions of a complex regulatory statute should be given their full weight and effect, in order to obviate the mischief to which the statute is directed, without

creating other greater, and avoidable mischiefs in its place. A statute to protect tenants against developer abuses should not be construed, in defiance of its internal logic and structure and general Congressional intent, as a piece of class legislation that assumes tenants can do no evil, while developers are stripped bare of their legal rights. Similarly, a statute that marks a consciously modest Congressional foray into an area normally reserved to state control should not be misread as a major federal initiative that displaces both state statutory schemes and common law rules directed to the same end -- the control of fraud and abuse.

These well-established principles have been systematically discarded twice by the Second Circuit--in this case, and in its earlier, unfortunate

decision in West 14th Street Commercial Corporation v. 5 West 14th Owners Corp., 815 F.2d 188 (2d. Cir.), cert. denied, 484 U.S. 850 (1987). Both cases give unscrupulous tenants wholly undeserved financial windfalls while casting an unnecessary pall over real estate conversion markets to the enormous detriment of tenants and developers generally.

The miscarriage in question started innocently enough when, on April 2, 1981, petitioner 2 Tudor City Place Associates ("Associates") purchased 2 Tudor Place, an apartment complex with a three story basement garage. On April 30, 1981, Associates and its wholly owned affiliate, petitioner 2 Tudor Parking Corp. ("Parking"), entered into a long term lease for an initial term of 24 years, with options for renewal of 20 and 15

years (the "Garage Lease"). Parking had no lease obligations to operate, maintain or manage the leased space, but was allowed to "use and occupy the demised premises for a garage as hereinafter provided or for any other lawful purpose." Parking could let the space remain wholly idle so long as it paid the stipulated rent. The Garage Lease contained no restrictions on the rates that Parking could charge for the use of its space; and it could sublet its garage space to any third party without prior approval from the landlord. No tenants had acquired any ownership interest in either the building or the garage at the time of this initial lease.

Over a year after the Garage Lease was executed, Associates began the process of converting the 2 Tudor Place complex into a cooperative. In August,

1982, it formed the respondent, 2 Tudor City Tenants Corp. ("Tenants"). The following year Associates filed a plan of conversion from rental units to cooperatives with the Attorney General of New York, where it was reviewed under a state law designed to insure that the proposed conversion as a whole did not work any hardship or fraud upon the tenants.

New York State accepted the plan on November 17, 1983, and ten days later the plan was circulated to the building's tenants, for their examination and approval. In July, 1984, the conversion plan became effective when more than 15 percent of the tenants accepted the offer, as required under New York State's Martin Act. N.Y. Gen. Bus. Law § 352-eeee et seq (McKinney 1984). The tenants who became unit-owners were sophisticated

purchasers who had the benefit of expert legal advice every step of the way.

At the closing, Associates assigned to Tenants its interest, as landlord, in the Garage Lease. As part of the offering, Associates had disclosed the terms of the Garage Lease so that Tenants had precise information as to the cash flow that it would receive as Associates' assignee. The offering disclosed three times what was obvious: "the Sponsor expects to make a profit with respect to the Garage Lease in the future."

As a result of the Garage Lease, and a favorable sublease Parking had entered into with Kinney Systems, Inc. ("Kinney"), Associates was able to reduce the sale price of the units sold to the tenants of its building. The rental payments to Associates, and

after the assignment, to Tenants, over the life of the Garage Lease escalated in accordance with a predetermined schedule, but for each period were set below the anticipated market value of the leased garage space. Initially, Parking was to receive annually some $350,000 more on its Kinney sublease than it paid to Tenants. These profits were used to defray the costs of overall operating expenses, and to cover investor shortfalls from the unsold apartments. Only after several years would any profits be made. Over the life of the lease and its two option periods, Parking was to receive approximately $46,000,000 in rentals from Kinney, and to pay out less than $19,000,000 in rentals to Associates, or its eventual assignee, Tenants. The effective difference over the life of the Garage Lease was $27,000,000, which

when discounted to present value, constituted a gain to Parking of just under $6,000,000.

By October, 1985, a sufficient number of units had been sold to allow the unit owners to elect their own Board of Directors. At a special meeting on June, 17, 1987, the unit owners voted to terminate the Garage Lease, invoking section 3607 of the Act. Shortly thereafter, Tenants struck a deal with Kinney that allowed Kinney to continue to operate the parking garage on the same terms and conditions as under its sublease with Parking. Tenants' machinations were intended to oust Parking from its favorable lease, and to allow Tenants to line their own pockets with the $6 million in anticipated profits that <u>everyone</u> had understood belonged to Parking under the terms of the original

deal. Associates was not so fortunate. As a result of the restructured transaction, it could no longer carry the loan on its unsold apartments, and it went bankrupt.

Associates and Parking commenced this action seeking, among other things, a declaratory judgment that the Garage Lease was not subject to the unilateral termination provisions of section 3607. Jurisdiction was premised on 15 U.S.C. §§3611 and 3612 and 28 U.S.C. §1331. Both the petitioners and respondent moved for partial summary judgment on the issue of whether the termination of the Garage Lease was effective. The Honorable Thomas P. Griesa, employing the same reasoning as had a New York State court in Park East Apartments, Inc. v. 233 East 86th Street Corporation, 139 Misc. 2d 806, 529

N.Y.S.2d 674 (Civ. Ct. N.Y.Cty. 1988), aff'd on other grounds, 143 Misc.2d 60, 543 N.Y.S.2d 610 (1st Dept. 1989), called a temporary halt to Tenants' scam by granting petitioners' motion. The District Court then certified the judgment as final pursuant to Rule 54(b) of the Federal Rules of Civil Procedure and respondent appealed.

On February 5, 1991, the Second Circuit reversed, holding that under section 3607, the Garge Lease was a contract for "the operation, maintenance, or management" of property serving the cooperative unit owners, which could be terminated without penalty by Tenants. Its decision thereby allowed Tenants to obtain the benefits of *both* the low purchase prices *and* the favorable lease with Kinney. Associates, which had complied with all the protective provisions of

New York State law, was left holding the bag. On March 21, 1991, the Second Circuit denied the petition for a rehearing and for rehearing en banc. As matters now stand, the sleight of hand sanctioned by the Second Circuit has rewarded Tenants with a deal more favorable than it, or anyone else, could have obtained in the marketplace.

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS BADLY MISCONTRUED SECTION 3607 OF THE ACT, AND FLOUTED CONGRESS' INTENT TO STRICTLY LIMIT FEDERAL REGULATION, BY HOLDING THAT SECTION 3607 AUTHORIZES TENANTS, UNILATERALLY AND WITHOUT CAUSE, TO TERMINATE A FULLY DISCLOSED, PRE-CONVERSION GARAGE LEASE

There are two reasons why the Act should not apply to the Garage Lease. First, there is no evidence that section 3607 embraces leases at all, let alone space leases entered into for

financial reasons without any obligation on the developer-lessee to provide for the "operation, maintenance or management" of the leased property. Second, section 3607 only applies when there is self-dealing, which can only arise after some tenants have purchased units and have some voting stake in the management of the building.

A. Section 3607 Does Not Cover The Financial Lease Between Associates and Pparking

The Act contains two key provisions -- section 3607 and section 3608. Section 3607 deals with "any contract" entered into after October 8, 1980, which "provides for the operation, maintenance, or management of . . . property serving the condominium or cooperative unit owners." It allows these contracts to be "terminated without penalty" by the unit owners so long as the contract was

entered into "while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in the corporation." 15 U.S.C. §3607(a)(3).

Section 3608 allows courts to fashion limited remedies for certain leases that are by elaborate statutory tests found to be unconscionable. Section 3608 is very limited in its scope; in contrast, section 3607 confers an extraordinary power on the tenants by allowing them to set aside contracts without any showing of cause. Under section 3607, there is no need to show fraud or duress in the formation of the agreement; nondisclosure of any material terms; or unfair or unconscionable contract terms. Indeed there is no need to go to court at all. Section 3607 creates a self-help

remedy.

Despite its breadth, section 3607 is obscure. The critical term "contract" is left undefined, even though the equally commonplace term "lease" receives a special definition under section 3603(16) of the Act. All leases are contracts insofar as they are created by agreement and not by the force of the state, just as land grants have been held to be contracts. Fletcher v. Peck, 10 U.S. 87 (1810). But, leases are also conveyances, Tiffany, Real Property, §74 (3d ed. 1939), and it is unclear whether, and, if so, which leases constitute contracts within the meaning of section 3607.

Section 3608 creates a very precise regime for leases, allowing for judicial modification on a showing of unconscionable terms only. Section

3609 uses the phrase "contract or lease" in a fashion that suggests a sharp opposition between them. Given Congress' precise use of the term "lease" elsewhere in the Act, it is clear that leases were intended to be covered by one section of the Act, and contracts, excluding leases, by the other.[1]

In West 14th Street, the Second Circuit developed an ingenious but fallacious argument to avoid this sensible construction.

> A "lease" as used in § 3608 is defined narrowly to include only property owned by the developer (or developer affiliated

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[1] "Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acted intentionally and purposely in the disparate inclusion or exclusion." Russello v. United States, 464 U.S. 16, 23 (1983), quoting United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972).

> companies) leased to the cooperative project; not, as here, cooperative property leased by the cooperative to the developer. § 3603. Hence, the limitations of § 3608 are not undercut if § 3607 is construed to apply to leases where the cooperative association is the lessor.

815 F.2d at 197 (emphasis in original).

The Court then added in a footnote:

> We see nothing anomalous in interpreting § 3607 to apply to leases of cooperative owned property to a sponsor affiliated company but not to leases which run in the other direction. Where the sponsor leases developer-owned facilities to the cooperative, it can hardly be said to be managing, maintaining, or operating that property for the cooperative, absent an explicit reservation of those responsibilities.

Id. at 197-98, n.4.

The peculiar definition of leases under Section 3603(16) of the Act -- namely, only those leases where the tenants are the lessees -- is intelligible only when read against the

backdrop of the legislative history. The reported abuses all took place in Florida and involved recreational leases requiring excessive or unconscionable payments from the tenant-lessees to the landlord-developers. Section 3608(a)(6) limited the reach of that section to leases of this sort entered into before June 4, 1975.

The Second Circuit's ground for distinguishing between leases covered by section 3607 and those covered by section 3608 makes no sense. "Absent an explicit reservation of those responsibilities," there is no more reason to assume a developer-tenant has undertaken service obligations than a developer-landlord. Whether the developer is lessor or lessee, the terms of the lease alone determine whether the lease is a service lease.

If "contracts" under section 3607 do not include leases with developers as landlords, then they do not include leases with developers as lessees.

The Second Circuit misread a limited federal statute as a charter for massive intervention into an area customarily governed by state law. To understand the full scope of its errors, it is necessary to delve further into two issues: first, what is a service lease, and second what is a self-dealing transaction.

B. Section 3607 Does Not Apply to Leases That do not Require the Developer to Provide For "Operation, Maintenance, or Management" of the Leased Property.

Section 3607 reaches only those contracts that provide for the "operation, maintenance, or management . . . of property serving the condominium or cooperative unit owners." Leases that require the

developer to render no services are excluded. The reason for this view is not only textual; it is functional as well. Section 3607 is designed to protect against developer abuses. Developers can skimp on services, a tactic exceedingly difficult for tenants to discover or control, or they can impose on tenants additional burdens through hidden escalation clauses. To protect against these forms of abuse, Congress devised the unilateral termination provisions of section 3607.

Neither of these abuses can be present in a case, like this one, not involving a service contact. Parking had no service obligations which would allow it to cheat Tenants. The only service obligations are minor maintenance obligations imposed on Tenants, as landlord. That Tenants

might shirk its service obligations is hardly a reason to allow it to set aside the Garage Lease. Similarly, the escalation clause contained in the Garage Lease did not impose a hidden burden on Tenants; it benefitted Tenants. Tenants knew exactly how much money it was entitled to receive under the Garage Lease. Tenants simply had to regard the future income flow as a financial asset on its books, which it could then discount to present value, just as if it were a corporate bond.

Even if section 3607 applies to some limited form of leases, under the section's express terms it can apply only where the developer (whether as lessor or lessee) has service obligations to the tenants. Section 3607 should not be read, as it was in this case, to allow tenants to set aside a lease where only the tenants

owe service obligations to the developer.

C. Section 3607 Only Applies to "Self-Dealing Transactions," and these Can Arise Only After the Control of the Board is Divided Between the Developer and the Tenants.

The fundamental purpose of section 3607 can be gleaned from the heading of the section: "Termination of self-dealing contracts." A self-dealing contract is not a contract in which the same person is the only party on both sides of the contract. Were that the case, the contract in question would transfer money from one pocket to the other, a benign occurrence. Self-dealing contracts are the subject of such suspicion because there is only a partial overlap in the identity of the parties, which allows abuse, indeed, a disguised sort of theft to take place. In self-dealing transactions the party who controls the corporate decision is

on both sides of the transaction in different proportions. R. Clark, Corporate Law, 141-189 (1986). The paradigmatic self-dealing transaction is "between a corporation and its directors or officers." Id. at 159. Self-dealing is rightly understood as a "unilateral taking of property rather than a bargained-for distribution of it." Id. at 154. Self-dealing involves exploitation of others, and cannot arise where one person only deals with himself.

The original Associates-Parking Garage Lease was not a self-dealing transaction covered by section 3607 because it was completed before Tenants had an interest in the Lease. Section 3607(a)(3) provides that a contract may be terminated by a cooperative association, without penalty, only if it "was entered into while such

association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association."[2] Cooperative associations have no power to terminate contracts or leases with developers created after the tenants control their association. Any risk of self-dealing has passed when tenants are the masters of their own fate. Nor should they have the power to terminate contracts or leases created before the cooperative association even existed. Section 3607 applies only to those contracts that were formed while there was divided control over the tenants.

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[2] The reference to a majority of the votes and the definition of "special developer control" in section 3603(22) both preclude the application of section 3607 to cases where tenants have no proprietary interests. One hundred percent of the votes is not a majority, for then there is no minority to be exploited.

The Second Circuit's facile paraphrase of the Act in the decision below obscures this relationship:

> The provision of the . . . Act under which Tenants terminated the lease, § 3607, provides a non-judicial remedy for cooperative associations when the developer, or an affiliate of the developer, has bound the cooperative association to a contract, prior to the time when the developer sells control of the cooperative to the unit-owner purchasers. (emphasis added) (A-5)

The Act contains no such provision: the words "prior to the time" are nowhere to be found in the Act. Their use makes it appear as though section 3607 applies to any transaction that takes place before the tenants assume control over the Board. But the exact language of section 3607(a)(3) recognizes that prior to the tenants taking ultimate control, there are two stages: the first, where the developer has exclusive control, and

the second, where control is divided. Both are covered by the phrase "prior to" tenant control. But the first of these is not covered by the statute; only the second is.

The Second Circuit repeated this textual error later in the opinion when it noted that "preconversion leases and contracts executed by the developer and its affiliates, such as tenant cooperatives with yet unsold shares, are self-dealing agreements." (A-7) But again, the Court failed to recognize the distinction between the two classes of "pre-conversion" agreements: those executed when the developer retains full control over all units, and those executed after divided ownership has taken place. Only the second constitute self-dealing arrangements. The Second Circuit, by giving a broad and unprecedented

interpretation to the concept of a "self-dealing transaction," enormously expanded the scope of federal intervention into rental conversions.

D. Petitioners' Construction of the Statute is Supported By the Best Reading of the Legislative History.

The legislative history of the Act is filled with its own fair share of paradoxes. The vast bulk of that history involves section 3608, whose importance necessarily had to diminish with time since it applies only to leases entered into before June 4, 1975. Congress was primarily concerned about developers who forced their tenants, many of whom had limited income, to become lessees of long term recreational leases containing hidden escalator clauses. Although the Senate sought extensive protection against such leases, the House of Representatives opposed the expansion

of federal power in this area and it prevailed. The remedies under section 3608, therefore, were limited. The Committee Report noted that in reaching a compromise, "the Committee recognized the arguments of developers that, in some circumstances, the leases enabled units to be marketed at substantially lower prices and provided a significant portion of the builder's profit on the project as a whole." S. Rep. No. 96-136, 96th Cong., 2d Sess. 52, reprinted in 1980 U.S. Code Cong. & Ad. News 3506, 3559.

In addition, both supporters and opponents of the Act agreed that the Act was not intended to displace the primary state responsibility in the area. The legislative history on this point at least is clear:

> The Committee does not feel that Federal legislation in this area, except on the subject of long-term

> escalating leasing arrangements for project-related facilities, is presently necessary or appropriate. Although some abuses have occurred in the marketing of condominiums and cooperatives, the states in which they took place have generally responded by enacting excellent and comprehensive regulatory schemes. . . . Given this situation, there appears to be no present justification for the enactment of Federal standards which could conflict with existing state law, and possibly diminish the level of new condominium starts which can make an important contribution to relieving the national shortage of affordable shelter.

Id. at 3556.[3]

Given the extensive consideration of and hard fought compromise over the leases governed by section 3608, the legislative history on section 3607 can

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[3] For similar views, see also 126 Cong. Rec. 15,963 (remarks of Sen. Williams); 126 Cong. Rec. 28, 442 (remarks of Rep. Reuss); 126 Cong. Rec. 28,444 (remarks of Rep. Ashley).

only be described as mystifying and inadequate. The Committee Report reads in full:

> OPTIONAL TERMINATION OF SELF-DEALING CONTRACTS
>
> Section 509 [now 3607] provides a means whereby the unit owners of a conversion project may terminate a long-term, self-dealing contractual arrangement without having to resort to judicial action.

1980 U.S. Code Cong. & Ad. News 3558.

The discussion of section 3607 in the Congressional Record is equally unilluminating. Senator Williams commented, in passing, that he was:

> pleased to note that the conferees did retain a provision of the Senate bill which provides a federally sanctioned, simple and nonjudicial method by which the residents of a conversion project may void a long term, self-dealing leasing arrangement.

126 Cong. Rec. 28, 178 (1980).

The contrast could not be odder. Congress lavished enormous attention on

section 3608, a complicated provision, confined to leases executed before June 4, 1975, with no long term consequences, but remained bafflingly silent about section 3607, which applies to contracts made after October 8, 1980, and whose significance would necessarily increase over time. Congress gave no consideration to the scope of the remedy provided under section 3607, to the transactions to which it applies, or to any of the issues of statutory construction raised in this petition.

In West 14th Street, the Second Circuit relied on two small strands of this sparse legislative history to justify its expansive reading of section 3607. It first stressed that Senator Williams had used the phrase "long-term self-dealing leasing arrangement" in referring to section

3607. 815 F.2d at 198. In so doing, the Court converted a casual remark into a high theory. Senator Williams' isolated and probably inadvertent comment did not represent a reasoned conclusion about the interaction of sections 3607 and 3608;[4] he did not even mention the two chief limitations on section 3607: that the contract be one for "the operation, maintenance, or management" of cooperative property and that it involve "self-dealing."

Second, the Court cryptically observed that four Senators had referred to "'lease provisions'" in

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[4] As one court has remarked, "in the course of oral argument on the Senate Floor, the choice of words by a Senator is not always accurate or exact." In re Carlson, 292 F.Supp. 778, 783 (D. Cal. 1968). Moreover, stray comments by a single legislator do not represent the views of the entire legislature. Garcia v. United States, 469 U.S. 70, 76 (1984); Weinberger v. Ross, 456 U.S. 25, 35 (1982).

discussing § 3607." West 14th Street, 815 F.2d 198. Here, the Second Circuit flatly misread the legislative history. Those Senators, who opposed the legislation, were referring to unconscionable recreational leases that contained escalator clauses. 1980 U.S. Code Cong. & Ad. News 3600 (Additional views of Senator Garn, Tower, Armstrong and Lugar). This is the very kind of lease that the Second Circuit had already held did not fall under section 3607. West 14th Street, 815 F.2d at 197-98. In fact, the sentence seized upon by the Second Circuit réfers to a provision of the original bill which ultimately was deleted as a concession to the House, which held more restrictive views on the desirability of the Act.

The Second Circuit's second argument in West 14th Street fares no

better. The Court wrote:

> a line drawn between leases and contracts would exalt form over substance. Leases, a species of contract, may contain covenants that require the lessee to perform certain contractual services for the landlord. . . . Thus, a lease, in substance, may be nothing more than a contract of operation.
>
> Finally, construing this statute so as to permit cooperatives to cancel only maintenance-type contracts but not leases would, contrary to Congress' aim, serve as an incentive to developers to try to retain as much control over cooperative property as possible. For example, a contract for the operation of a laundry room, where the developer retained a fair percentage of the profits would be terminable, while a lease for the same laundry room space where the laundry room-tenant (developer) paid a below market fixed rent would not be. Such an anomalous result would thwart Congress's plan.

West 14th Street, 815 F.2d at 198 (emphasis in original).

This form/substance point does not

explain why section 3607 should apply to a lease, like the Garage Lease here, that does not require the developer to render any services. More generally, the Second Circuit incorrectly assumed that Congress intended the Act to have a broad, even aggressive, scope. At no point in either this case or in West 14th Street does the Second Circuit advert to those key passages of the legislative history that clearly show that Congress meant to leave the regulation of condominium and cooperative conversions primarily to the states.

Congress, with its strong sensitivity to federalism questions, intended the future control of abusive leases to be governed by state law. Its intention is ignored if tenants from Florida to New York can set aside all leases at will without any showing

of unconscionability. Congress deliberately made the under-inclusiveness of federal control a central mission of the Act. Even section 3608, the crux of the Act, could not have been passed if its modest remedies had been applied to future leases. How then can the Second Circuit be correct when it construes the more draconian section 3607 to cover these same leases?

The blunt truth is that even if section 3607 is properly confined to self-dealing service contracts entered into after October 8, 1980, it remains broader in scope than any of the drafters thought possible at the time of its passage. Congress had no "plan" that a more restrictive interpretation of the Act would "thwart." The odd bits of legislative history on which the Second Circuit relied are utterly

unable to justify the juggernaut that it has unleashed in the world of condominium and cooperative conversions.

II. THE INCORRECT INTERPRETATION OF THE ACT HAS UNDESIRABLE SOCIAL CONSEQUENCES THAT WILL THWART THE GENERAL INTENTION OF CONGRESS

The case against the Second Circuit's construction of the Act has a third prong: its widespread invalidation of leases from cooperative associations to developers and their affiliates will frustrate the very conversion of rental housing to condominiums and cooperatives that Congress wished to foster. In this particular case, the consequences of statutory construction appear to be solely distributive: who will receive the $6,000,000 that Tenants has taken from petitioners. But that view is unduly narrow for two reasons.

First, by allowing tenants to set

aside leases without cause, innocent third parties will be prejudiced. In this case, Kinney, the sublessee, has been forced to incur additional expenses to protect its legal position. In other cases, the tenants may terminate a lease only to then demand a higher rent from the original sublessee, or to relet the premises to its competitor. Invalidation of the lease transaction thus has ripple effects that harm innocent third parties.

Second, the invalidation of this lease will have important ramifications for other condominium and cooperative conversions. At one level, there is sheer confusion given that a New York State court has fully vindicated petitioners' view of the Act. Park East Apartments, Inc. v. 233 East 86th Street Corporation, 139 Misc. 2d 806,

529 N.Y.S.2d 674 (Civ. Ct. N.Y. Cty. 1988), aff'd on other grounds, 143 Misc.2d 60, 543 N.Y.S.2d 610 (1st Dept. 1989). Since both state and federal courts have concurrent jurisdiction under the Act, 15 U.S.C. §3611, an unseemly conflict has arisen which will encourage tenants and developers to spurn voluntary settlements, and to rush to court in order to obtain the advantage of a favorable jurisdiction. Unless this Court clears up the statutory tangle, it is doubtful that any prudent developer will ever try to recover either costs or profits through financial subleases. The legal risks are obviously far too great.

This developer caution will not only hurt developers. It will hurt tenants as well. These leases offered advantages to both sides. For developers, they generated a steady

stream of cash from a reliable sublessee of its own choosing. For tenants, they allowed lower prices on condominium and cooperative units, simplifying their financing. By reducing the capital requirements of buyers the financing method used by Associates increased the likelihood that sitting tenants could purchase units at favorable prices, reduced the delay and uncertainty of conversion, and economized on a tenant's lending costs. In a world without friction these might seem to be small advantages, but in a world with high transaction costs, sound business practices depend on an accumulation of small transactional savings.

To benefit the greedy tenants in the instant case, the Second Circuit invalidated a sensible practice and has made it impossible for future tenants

to bind themselves to an agreement that it is in their business interest to follow. There is no reason why that perverse result should stand. It is not compelled by the statute's language, by its legislative history, or by its larger social context.

III. THE ACT, AS CONSTRUED BY THE SECOND CIRCUIT, WORKS AN UNCONSTITUTIONAL INFRINGEMENT OF INDIVIDUAL LIBERTY AND A TAKING OF PRIVATE PROPERTY WITHOUT JUST COMPENSATION

The Second Circuit's extraordinarily broad construction of section 3607 creates serious questions about its constitutionality under the Fifth Amendment to the Constitution. The Fifth Amendment affords two sources of protection to private property against encroachment by the government. The Takings Clause provides that private property should not be taken for public use without just compensation; the Due Process Clause

provides that no person shall be denied life, liberty or property without due process of law.

Although this Court has on occasion narrowly construed these clauses, see, e.g., Penn Central Transportation Co. v. City of New York, 438 U.S. 104 (1978), it has also acknowledged their enormous importance in our constitutional scheme. See Nollan v. California Costal Commission, 483 U.S. 825 (1987); First English Evangelical Lutheran Church of Gendlae v. County of Los Angeles, 482 U.S. 304 (1987). Indeed, the Court has recognized that individual liberty includes the right to dispose of property as an owner sees fit, and that the ownership of property likewise includes the right to dispose of the property owned. See United States v. General Motors, 323 U.S. 373, 377

(1945). The Second Circuit ignored these rulings in its rush to rewrite the law, and has enabled Tenants to infringe on petitioners' constitutionally protected interests.

The protection accorded economic liberty and private property under the Fifth Amendment is not absolute; the state will prevail if (a) just compensation is accorded to the owner of the property in either cash or in kind, or (b) if the state has some interest -- some rational basis -- to justify its restriction on liberty or property rights. But section 3607 of the Act affords no compensation to the real estate developer, either before the lease is made or afterwards. Nor has Congress supplied <u>any</u> justification for section 3607, as that section has now been construed by the Second Circuit.

The Second Circuit heedlessly dismissed these important constitutional isues with a single sentence: "Laws and statutes in existence at the time a contract is executed are considered a part of the contract, as though they are expressly incorporated herein." (A-15) Under this unprecedented standard, the mere publication of a statute allows it to survive constitutional attack. Yet as long as the rational basis test requires Congress to construct some justification to support legislation that divests one of ownership of property, then that standard must be constitutionally infirm.

Clearly, there is no rational basis to support the Second Circuit's construction of the Act. Congress determined that limited relief was necessary to protect tenants who

executed abusive leases before June 4, 1975. It also recognized that there were greater protections under state law for leases executed after that date. No one in Congress thought that section 3607 would play the major role envisioned and implemented by the Second Circuit. The Congressional compromise, achieved to minimize federal intervention in an area traditionally subject to state control, was designed to preclude that effect. There is no rational basis for allowing poor drafting to result in a greater remedy for a lesser evil. Section 3607 of the Act, when applied to the very broad class of transactions covered by the Second Circuit's ruling, seizes property without just compensation and serves no legitimate constitutional end.

CONCLUSION

The issues raised by this case are stark and simple. There is an enormous debate on statutory construction, about the appropriate weight that should be given to text, to structure, to context, to legislative history, and to legislative purpose. Petitioners recognize, indeed insist, that the Condominium and Cooperative Abuse Relief Act is badly drafted. But it is not wholly incoherent. No matter what weight is given to the various factors at issue in this case, the decisions of the Second Circuit in West 14th Street and in this case are clearly wrong and worthy of review, so long as the

applicable rule of construction is not "the tenant must always win."

Respectfully submitted,

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Dated: June 12, 1991
New York, New York

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 684—August Term, 1990

Argued: October 17, 1990 Decided: February 5, 1991

Docket No. 90-7739

2 TUDOR CITY PLACE ASSOCIATES and
2 TUDOR GARDEN PARKING CORP.,

Plaintiffs-Appellees,

—against—

2 TUDOR CITY TENANTS CORP., KINNEY SYSTEMS, INC., and AMERICAN SAVINGS BANK,

Defendants-Appellants.

Before:

OAKES, *Chief Judge*,
LUMBARD, and WINTER, *Circuit Judges*.

Appeal from judgment and order of the Southern District of New York, Griesa, *J.*, granting summary judgment to appellees and denying appellant's cross-motion for summary judgment in appellees' suit to avoid appel-

lant's nullification of a parking garage lease pursuant to 15 U.S.C. § 3607 (1988).

Reversed.

NATHAN Z. DERSHOWITZ, New York, N.Y. (Dershowitz & Eiger, P.C., New York, N.Y., Jan Ira Gellis, of counsel), *for Plaintiffs-Appellees.*

YVETTE HARMON, New York, N.Y. (Ross & Hardies, New York, N.Y., Michelle d'Arcambal, of counsel), *for Defendant-Appellant 2 Tudor City Tenants Corp.*

LUMBARD, *Circuit Judge*:

The plaintiffs, 2 Tudor City Place Associates (Associates) and 2 Tudor Garden Parking Corp. (Parking), brought suit against 2 Tudor City Tenants Corp. (Tenants) in the Southern District of New York to prevent the nullification of the lease (between Tenants and Parking) of a parking garage at 2 Tudor City Place.[1] Tenants, a cooperative association, had nullified the lease pursuant to the Condominium and Cooperative Conversion Protection and Abuse Relief Act (Act), 15 U.S.C. § 3607 (1988). The purchasers of the apartments at 2 Tudor City Place believed that they had not been advised that the lease of the garage to Parking improp-

1 Kinney System, Inc. and American Saving Bank were both named as defendants in the amended complaint. However, plaintiffs did not move for summary judgment against those parties.

erly benefited the developer of the cooperative project at the expense of Tenants.

The complaint alleged both an illegal § 3607 termination and common law proxy fraud. Upon cross-motions for summary judgment, Judge Griesa granted plaintiffs' motion as to the § 3607 claim, and denied Tenants' motion. After entering judgment in favor of Associates and Parking, the district court granted Tenants' motion for certification to this court under Fed. R. Civ. P. 54(b).

On appeal, Tenants claims that the district court erred in holding that Tenants had no power to terminate the parking garage lease between Tenants and Parking. We agree and reverse the judgment, and direct entry of judgment in favor of Tenants on the § 3607 claim.

I.

The material facts are undisputed. 2 Tudor City Place is a 333 unit residential complex at 330 East 41st Street, east of Second Avenue. On April 4, 1981, Associates, a partnership, purchased 2 Tudor City Place and an adjacent parking garage. It acquired the ground lease, but not ownership of the land. In that same month, Associates incorporated Parking. The officers and directors of Parking consisted of the principals of Associates. Associates leased the garage to its shell corporation, Parking, which in turn, subleased it to Frances Corrao, the garage operator at that time. The lease between Associates and Parking provided that if ownership of the garage changed, the new owner would replace Associates as lessor if the new owner assumed the covenants in the lease.

On August 5, 1982, the principals of Associates incorporated Tenants. Associates intended to profit from its development of the 2 Tudor City property by selling the shares of Tenants to purchasers of the apartments. Tenants adopted a pre-incorporation contract with Associates whereby Associates sold the building and parking garage to Tenants. The contract transferred to Tenants the leases to which Associates had become a party prior to its sale of 2 Tudor City Place to Tenants. However, the terms of this contract provided that Associates remained free to alter the terms of these leases, which included the lease to the parking garage, subject only to written approval by the party to be charged with the alteration. That is, Associates could change the leases as long as Tenants approved. The effect of such a provision was that until Associates divested itself of a majority of the shares in Tenants, it had unlimited power to alter the terms of the garage lease.

On November 5, 1982, as part of the cooperative conversion process, Associates filed a preliminary prospectus with the New York Attorney General's office, as required by state law. On November 16, 1983, an Offering Plan, similar to a securities registration statement, was accepted for filing by the Office of the Attorney General. It revealed that Tenants had leased the parking garage to Parking. It also disclosed the amount of rent Parking was to pay Tenants, that Tenants was responsible for major repairs to the garage and that the ultimate expiration date of the lease was April 30, 2040, with a right to extend the lease if the ground lease is renewed. Although the Offering Plan revealed that the rent Parking was to pay Tenants under the lease was then $340,000 annually,[2] it did not reveal the market value of

2 Under the lease, the annual rent escalates $10,000 every five years.

the garage lease. Parking presently collects $775,000 annually from Kinney Systems, Inc., the sub-lessee and current garage operator. Thus, for at least fifty years, Tenants is bound to a lease under which the rent it receives will almost certainly be substantially less than the market value of the garage.

Associates held two closings at which it sold cooperative shares to unit-owner investors in Tenants: on July 24, 1985, it divested itself of 106 of the 333 units, and 103 of the remaining units were sold on October 1, 1985. At the first closing, Associates and Tenants executed an assignment and assumption whereby the rights and duties of Associates as landlord of the garage lease were transferred to Tenants.

On July 17, 1987, the shareholders of Tenants voted to terminate the garage lease with Parking pursuant to § 3607. On August 13, 1987, Associates and Parking brought this action claiming that Tenants had no right to terminate the lease.

The provision of the Condominium and Cooperative Conversion Protection and Abuse Relief Act under which Tenants terminated the lease, § 3607, provides a non-judicial remedy for cooperative associations when the developer, or an affiliate of the developer, has bound the cooperative association to a contract, prior to the time when the developer sells control of the cooperative to the unit-owner purchasers. In such cases, the cooperative association may, by a two-thirds vote of the unit-owners, terminate the contract within two years of the time when the developer, or its affiliate, has relinquished control of the association or owns less than twenty-five percent of the apartments in the project.

The district court found that the assignment and assumption of the garage lease, executed concurrently with the July 24, 1985 closing, terminated the old lease and created a second lease. Instead of one garage lease, the district court termed the pre-assignment and assumption portion of the lease the "pre-closing lease", and held that as a result of the assignment and assumption, a second "garage lease" was created. Judge Griesa further held that because Tenants was not a party to the "pre-closing lease", signed by Associates and Parking, it had no power to terminate that lease under the authority of the Act.

II.

Tenants contends that the district court erred by holding that it had no power to terminate the garage lease. We agree. There is only one garage lease relevant to this case. That lease was originally executed by Associates, as lessor, and its related shell corporation, Parking. After the 1985 assignment and assumption, Tenants came to stand in Associates' place as lessor of the garage to Parking.

The garage lease, initially signed by Associates and Parking in 1981, provided that in the event ownership of the garage should change, the purchaser would become the new landlord if it assumed all the obligations of Associates. At the first closing in 1985, Tenants, still under the control of Associates, agreed to assume these responsibilities and thereby it became the lessor of the garage. The lease further provided that "[t]he covenants and agreements contained in this Lease shall bind and inure to the benefit of [the current lessor's] successors and assigns." Thus, by its terms, the lease expressly

allowed for the assignment and assumption of the lessor's rights and duties.

Associates argues that Tenants was not an original party to the Associates-Parking lease, and hence could not terminate it. To the contrary, if the formality of which party signed the operative document in § 3607 terminations was given legal effect, it would undermine the policy of the Act. Pre-conversion leases and contracts executed by the developer and its affiliates, such as tenant cooperatives with yet unsold shares, are self-dealing agreements. The developer stands on both sides of the bargaining table because it still controls its affiliate. Because the developer controls all parties at the pre-conversion stage, it can, as Associates did, enter into a self-dealing contract with an affiliate and then transfer its contractual obligations to a cooperative association. Not to apply § 3607 merely because the developer has altered the form of its self-dealing transactions would provide an easy avenue for avoidance of that provision of the Act, the purpose of which was to "alleviate developer abuses during the conversion process." *West 14th Street Commercial Corp. v. 5 West 14th Owners Corp.*, 815 F.2d 188, 190 (2d Cir.), *cert. denied* 484 U.S. 850, 871 (1987).

The recent decision in *Coliseum Park Apartments Co. v. Coliseum Tenants Corp.*, 742 F. Supp. 128 (S.D.N.Y. 1990) is in accord with our conclusion. In that case, as here, the garage lease at issue had been executed by the sponsor and its affiliate before the formation of the tenant cooperative and the filing of the offering plan with the state Attorney General, and the lease provided that the new owner would become the lessor in the existing garage lease if the new owner assumed its obligations.

Unlike the case at bar, there was no assignment and assumption agreement passing the rights and duties of the sponsor/landlord to the tenant corporation. Nevertheless, Judge Leisure held that at the closing, the cooperative became the party to the garage lease with the developer's affiliate, and therefore, the lease could be terminated by the cooperative association because it was between the sponsor's affiliate and the cooperative association. *See also Bank of New York, Albany v. Hirschfeld*, 37 N.Y.2d 501, 506, 374 N.Y.S.2d 100, 103 (1975) (similar lease provision held to transfer rights and obligations of lessor to purchaser of real estate upon purchaser's failure to object to lease covenants). Tenants became the lessor of the garage when it assumed the duties of landlord in 1985 in accordance with the terms of both the lease and the assignment and assumption. Hence, it had the power under § 3607 to terminate the lease with Parking.

III.

Associates contends that § 3607 does not apply to leases because the text of the section references only "contracts". There is no merit to this contention. Nothing in the extensive legislative history of the Act suggests that Congress meant to exclude leases from the term "contract". The lease was a contract which provided for the "operation, maintenance and management" of a garage which "serv[ed] the . . . cooperative unit owners." 15 U.S.C. § 3607(a)(1). As we recently held in *West 14th St.*, § 3607 covers leases as a species of "contract". 815 F.2d at 197-98. Thus, Tenants could avail itself of the termination remedy under the Act.

IV.

Further, the undisputed facts in the record show that the lease falls within the limitations prescribed in §§ 3607(a)(1)-(4), and accordingly Tenants was empowered to terminate the garage lease. Section 3607(a) provides:

> Any contract or portion thereof which is entered into after October 8, 1980, and which—
>
> (1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property serving the condominium or cooperative unit owners in such project;
>
> (2) is between such unit owners or such association and the developer or an affiliate of the developer;
>
> (3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and
>
> (4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,
>
> may be terminated without penalty by such unit owners or such association.

Beyond any doubt, the garage serves the cooperative unit-owners as required by § 3607(a)(1). In *West 14th St.*, we held that a parking garage was "property serving the . . . cooperative unit owners," § 3607(a)(1) even

though the garage did not exclusively serve residents of the building. 815 F.2d at 198-99. To hold otherwise, as Judge Cardamone noted, would permit developers to avoid § 3607 simply by opening a limited number of garage spaces to the public. *Id.* at 198.

After reviewing the statute's legislative history, we concluded in *West 14th St.* that the property need only primarily benefit the unit-owners. 815 F.2d at 198. Tenants' Certificate of Occupancy gave a preference to unit-owners for garage spaces. Because the garage primarily served Tenants, the lease was of the type covered by § 3607(a)(1).

We find that the three other criteria of § 3607(a) are also satisfied. Section 3607(a)(2) requires that the contract be between the "unit owners or such association and the developer or an affiliate of the developer." Section 3603(1) defines affiliate as "any person who controls, is controlled by, or is under common control with a developer."[3]

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3 Control is defined by § 3603(1):

> A person "controls" a developer if the person (A) is a general partner, officer, director, or employer of the developer, (B) directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interest of the developer, (C) controls in any manner the election of a majority of the directors of the developer, or (D) has contributed more than 20 per centum of the capital of the developer. A person "is controlled by" a developer if the developer (i) is a general partner, officer, director or employer of the person, (ii) directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interests of the person, (iii) controls in any manner the election of a majority of the directors, or (iv) has contributed more than 20 per centum of the capital of the person.

The garage lease was between Tenants and Parking. Parking was incorporated by the principals of the developer, Associates. At all relevant times, the officers and shareholders of Parking were the principals of Associates. Such control of Parking renders it an affiliate of Associates. *See* 15 U.S.C. § 3603(1). Hence, the lease between Parking and Tenants falls within § 3607(a)(2).

Section 3607(a)(3) requires the contract to have been entered into when the developer controlled the cooperative association. Here, Tenants became a party to the lease on July 24, 1985 when it assumed the garage lease. As discussed *infra*, Tenants was under "special developer control" until October 30, 1985, when the unit-owners elected an independent board of directors. Thus, as required by § 3607(a)(3), the lease was "entered into while such association was controlled by the developer through special developer control."

Section 3607(a)(4) states that the contract must extend for at least three years, including any automatic renewal provisions. Here, the garage lease does not expire until April 2005, with automatic renewal by Parking for successive terms of twenty and fifteen years.

Tenants has shown that the parking garage lease was terminable under §§ 3607(a)(1)-(4).

V.

The lease was terminated by the unit-owners within two years of the termination of "special developer control", by a two-thirds vote, as required by § 3607(b).

Section 3607(b) provides that contract termination by the unit owners must occur within two years of the ter-

mination of "special developer control" or when the developer owns only twenty-five percent of the units or less.[4] Section 3607(d) declares that the termination is not effective until ninety days after mailing notice of the requisite two-thirds unit-owners vote. Because Associates owned more than twenty-five percent of the units during all relevant time periods, it is necessary to determine when "special developer control" terminated.

The § 3607 termination vote occurred on June 17, 1987. On June 18, the termination notice was mailed to Associates. Under § 3607(d), it became effective ninety days later on September 16, 1987. For the notice to have been timely, "special developer control" must have existed at least until September 16, 1985.

Section 3603(22) defines "special developer control" as any right arising under state law or by way of a written instrument whereby the developer has power to control the cooperative association. It excludes from this definition the mere ownership of shares allocable to the units still owned by the developer. Thus, Associates claims that "special developer control" terminated on July 24, 1985, the date of the first closing. On that date, 22,985 shares allocable to 106 apartments were sold to shareholders. Although Associates still held a majority of the shares in Tenants, this was not a relevant factor according to § 3603(22). Conversely, Tenants asserts

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4 Section 3607(b), in its entirety, states:

> Any termination under this section may occur only during the two-year period beginning on the date on which—
>
> (1) special developer control over the association is terminated; or
>
> (2) the developer owns 25 per centum or less of the units in the conversion project,
>
> whichever occurs first.

that "special developer control" terminated on October 30, 1985, when the first independent board of directors was elected.

Special developer control did not terminate until Tenants elected an independent board of directors. In *West 14th St.*, we equated "special developer control" with developer domination of the cooperative board of directors. 815 F.2d at 200. In addition, both *Brabert Realty Co. v. 20125 Owners Corp.*, 703 F. Supp. 314, 316-17 (S.D.N.Y. 1989) and *181 East 73rd Street Co. v. 181 East 73rd Tenants Corp.*, 87 Civ. 3362 (S.D.N.Y. May 2, 1988) have held that the developer exercises "special developer control" when it dominates the cooperative's board of directors. In the case at bar, the unit-owners did not elect an independent board of directors until October 30, 1985. Therefore, the effective date of the leasehold termination, September 16, 1987, is within the two year limitation of § 3607(b), and is timely.[5]

VI.

The disclosure of the lease and its terms in the Offering Plan did not deprive Tenants of its right to terminate the lease, as Associates argues.

---

5 Associates also makes a related argument that Tenants did not terminate the lease in a timely manner given the six year statute of limitations in 15 U.S.C. § 3613 (1988). However, § 3613 reads:

> No *action* shall be maintained to enforce any right or liability created by this chapter unless brought within six years after such action accrued . . .

(emphasis added). It is Associates, not Tenants, which seeks to enforce rights under the Act. Section 3613 does not set a limitation on the time for contract termination under § 3607, a non-judicial remedy. Rather, it is § 3607(b) that serves as a time limitation on such terminations.

Facially, the statute is devoid of any indication of a disclosure defense. To read such a defense into the statute would render § 3607 little more than a disclosure statute. In addition, it is unrealistic to expect prospective homeowners to understand all the financial data revealed in the offering materials. The average cooperative buyer is vulnerable to the practices of developers who may bury the hidden costs of self-dealing contracts in lengthy, legally-mandated disclosure documents. Indeed, in this case, Associates, disclosed the rent and the long-term nature of the lease in the midst of its 607 page Offering Plan. Yet, it did not disclose the disparity between the garage's market value and the rent Parking was to pay Tenants. The Offering Plan merely stated that Associates expected, "to make a profit with respect to the Garage Lease in the future." Only a legal or real estate expert could discern the possible extent of such profit. The amount of this profit would not become known to the typical purchaser of Tenants shares until Associates relinquished control of Tenants, and an independent board of directors was elected.

In *West 14th St.*, we rejected the developer's contention that § 3607 was inapplicable because the contracts were the result of negotiations with the tenant group. 815 at 200-201. The situation presently before the court is a more compelling case for allowing a § 3607 termination. Unlike *West 14th St.*, there was no direct disclosure in negotiations. The only disclosure of the self-dealing lease was buried in the offering materials. *See also Coliseum Park*, 742 F. Supp. 128 (S.D.N.Y. 1990) (declining to construe § 3607 as having a disclosure defense).

VII.

The provisions of § 3607 which authorize the termination of developer dominated arrangements do not violate the fifth amendment proscription that "private property [shall not] be taken for public use without just compensation."

Congress passed the Act in 1980. The garage lease was executed the following year. Laws and statutes in existence at the time a contract is executed are considered a part of the contract, as though they were expressly incorporated therein. Hence, the Act does not violate the takings clause.

VIII.

Judge Griesa disposed of this case below by granting Associates' motion for summary judgment and denying Tenants' motion for summary judgment. Associates argues that even if we reverse the district court's judgment in its favor, summary judgment in favor of Tenants should not be directed because there are material issues of fact relating to whether Tenants' proxy statement was fraudulent and whether Tenants' board of directors ratified the garage lease. We disagree.

Associates has not alleged any facts to support the proxy fraud and ratification claims, it relies instead on Fed. R. Civ. P. 56(f), which gives the district court discretion in denying summary judgment when it appears from the non-movant's affidavits that more discovery is necessary before a decision should be made.

Rule 56(f) is of no aid to the plaintiffs. Even if Associates was allowed to conduct discovery as to proxy

fraud and ratification, those claims do not constitute a defense to a § 3607 termination. The Act is devoid of any indication that state law claims serve as a supplement to what Congress enacted. The only procedural requirement for the termination vote is that two thirds of the unit-owners, exclusive of units owned by the developer, must approve of the termination. 15 U.S.C. § 3607(c). Associates has not alleged that this requirement was not met. The other points advanced by Associates and Parking do not merit discussion.

IX.

There being no issue of material fact, the judgment of the district court is reversed with instructions to grant summary judgment in favor of Tenants on the § 3607 claim.

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - - - - - - - - - - - - - - X

2 TUDOR CITY PLACE ASSOCIATES and 2 TUDOR GARDEN PARKING CORP.,

87 CIV. 5850 (TPG)

Plaintiffs,

-against-

OPINION

2 TUDOR CITY TENANTS CORP., KINNEY SYSTEM, INC. and AMERICAN SAVINGS BANK, FSB,

Defendants,

- - - - - - - - - - - - - - - - - - X

2 TUDOR CITY TENANTS CORP., WILLIAM MACARTHUR, EDAN UNTERMAN, JODY SCHAEFFER, GRACE LURTON, NEIL JANSEN, JOSEPH LAPOINTE and WILMA P. GOTTLIEB,

Defendants and Additional Plaintiffs on Counterclaims,

-against-

SEAFIELD ASSOCIATES, et al.,

Additional Defendants on Counterclaims.

- - - - - - - - - - - - - - - - - - X

This action arises out of the cooperative conversion of an apartment building. Plaintiff 2 Tudor City Place

Associates ("Associates") was the owner of the building and sponsor of the conversion. The other plaintiff 2 Tudor Garden Parking Corp. ("Parking") is an affiliate of Associates and is the lessee of the building's garage.

Following the cooperative conversion, the new owner of the building, defendant 2 Tudor City Tenants Corp. ("Tenants Corp.") purported to terminate the garage lease pursuant to The Condominium and Cooperative Abuse Relief Act of 1980, 15 U.S.C. §§3601 et seq. In this action plaintiffs request a declaratory judgment to the effect that Tenants Corp. had no right to terminate the garage lease and that the garage lease in favor of Parking is still in existence. The right eight claims of the eleven-claim amended complaint relate to this request. The next two

claims seek relief designed to protect plaintiffs in the event that the court should rule that Tenants Corp. had the right to terminate the garage lease. In claims nine and ten plaintiffs allege that, if the garage lease is held to be terminable, plaintiffs are entitled to nullify the entire cooperative conversion on the basis of unilateral mistake, mutual mistake, or unjust enrichment. Finally, in claim eleven plaintiffs seek a judgment against defendant Kinney System, Inc. requiring Kinney to honor Parking's sublease with it.

Tenants Corp. and certain individual apartment owners have filed counterclaims seeking a declaration that the garage lease was properly terminated under the above statute and is void under certain other legal doctrines. A claim is also asserted

against Kinney seeking a declaration of Tenants Corp.'s rights against Kinney. Additional defendants are brought in one of the counterclaims, consisting of parties connected with Associates.

Another set of pleadings has been interposed setting up various claims by way of interpleader. The caption on the interpleader matter lists a host of parties and is not included in the caption for this opinion. The interpleader does not change the basic issues in the case.

The issue which is at the foundation of this litigation is whether the new owners of the cooperative had a right to terminate the garage lease under the federal statute. The positions of the two sides on this question have been set forth in cross-motions for summary judgment.

The court has determined that the statute gave Tenants Corp. no right to terminate the garage lease.

FACTS

On April 1, 1981 Associates purchased 2 Tudor City Place, an apartment building in New York City. In the basement of the building is a three-story garage. On April 30, 1981 Associates as lessor entered into a long-term lease for the garage with its affiliate Parking as lessee. The expiration date of the lease is April 30, 2005. The lease includes two renewal provisions, one for 20 years and the other for 15 years. The April 30, 1981 lease was amended by three supplements. The first supplement dated September 15, 1982 changed the rental terms. The second supplement dated January 24, 1983 shifted the

obligation to maintain the garage elevator from Parking to Associates. The last supplement dated April 12, 1984 changed the case year in the tax escalation clause from 1970-71 to 1986-87. On July 2, 1984 Parking entered into a sublease with defendant Kinney to operate the garage premises.

On August 5, 1982 Associates began the process of converting the building into a cooperative and formed defendant Tenants Corp. On November 17, 1983 the cooperative plan was accepted for filing by the Attorney General of the State of New York. On November 27 the offering plan was distributed to the building's tenants. On July 18, 1984 the plan was declared effective because 62 tenants had signed subscription agreements -- more than 15 percent of the building's tenants.

The offering plan disclosed and

described the existing garage lease between Associates and Parking. The "Special Risks" section of the plan stated that:

> The Apartment Corporation [Tenants Corp.] will acquire the Leasehold Property subject to a Garage Lease with 2 Tudor Garden Parking Corp., an affiliate of the Sponsor [Associates], which provides for an initial term expiring on April 30, 2005 with provisions for a first renewal term of 20 years and a second renewal term of 15 years. The Sponsor represents that present and future rent payable by the tenant [Parking] is sufficient to cover the ordinary expenses fairly attributable to the leased space. The Sponsor expects to make a profit with respect to the Garage Lease in the future.

The statement that "the Sponsor expects to make a profit with respect to the Garage Lease in the future" appeared at three places in the plan. See The Cooperative Offering Plan, at v, 108, 119. Subsequent amendments to the plan disclosed the changes made by the supplements to the garage lease.

The profit expected to be earned

by Associates' affiliate, Parking, from the garage lease affected the financial structure of the conversion. The expected profit enabled Associates to sell the apartments at lower prices and to cover any shortfall between the rent received from the apartments not purchased and their carrying charges.

Two closings were held. At the first closing on July 25, 1985, 106 apartments were purchased; the remaining 227 apartments were transferred to Associates. As part of the first closing, among other things, Associates assigned to Tenants Corp. its interest as lessor on the garage lease. At the second closing on October 1, 1985, 103 of the remaining 227 units were sold.

On October 30, 1985 Tenants Corp.'s first independent board of directors was elected. Thereafter, the

board decided to propose that the shareholders terminate the garage lease pursuant to The Condominium and Cooperative Abuse Relief Act of 1980 and obtained a shareholder vote to this effect.

As will appear hereafter, Tenants Corp. now takes a rather confused stance about what it was that it actually terminated. In certain of its submissions, Tenants Corp. argues that the attempted termination applied not only to the garage lease of 1981 but also to the assignment of 1985. Therefore it is necessary to examine with some precision what was actually done in this regard.

On May 26, 1987 the new board of directors of Tenants Corp. sent to the shareholders a notice of a special meeting to be held on June 17, 1987. This notice stated that a resolution

would be submitted to the special meeting

> terminating the Garage Lease which has an initial term expiring on April 30, 2005 (with a provision for a first renewal term of 20 years and a second renewal term of 15 years.)

This obviously referred to the 1981 garage lease. No mention was made of the 1985 assignment.

The notice was accompanied by a proxy statement dated May 26, 1987. The board of directors announced that is was soliciting the proxy of each shareholder to vote in favor of "termination of the garage lease." The details of the garage lease were described, and the description clearly related to the 1981 lease. No mention was made of the 1985 assignment. Each shareholder was asked to execute a proxy, indicating a vote in favor of or against "Termination of Garage Lease." There was nothing in the proxies about

the 1985 assignment.

At the June 17, 1987 meeting the resolution recommended by the board was passed by a vote of 213 apartment owners to 6. The minutes of that meeting have not been submitted to the court to show the actual wording of the resolution. However, the court has been furnished with the "Report of Inspectors of Voting," which records the votes for and against what is described as "Termination of Garage Lease." Again, no mention was made of the 1985 assignement [sic].

It can hardly be questioned that what was voted on by the new apartment owners was the termination of the 1981 lease, nothing more, and nothing less.

No vote of the unit holders was ever taken subsequent to the June 17, 1987 meeting to terminate the 1985 assignment.

DISCUSSION

The relevant statutory provision is 15 U.S.C. §3607(a), which states that a cooperative association such as Tenants Corp. has the right to terminate any contract that:

> (1) provides for operation, maintenance, or management of a . . . cooperative association in a conversion project, or of property serving the . . . cooperative unit owners in such project; (2) is between such unit owners or such association and the developer or an affiliate of the developer; (3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and (4) is for a period of more than three years . . . .

All four elements must exist for a contract to be terminated under the statute. West 14th St. Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188, 197 (2d Cir.), cert. denied, 484 U.S. 850 (1987).

A termination of a contract under

§3607(a) shall be by a vote of owners of at least two-thirds of the units other than those owned by the developer. §3607(c). There is also a time limit under the statute for terminating a contract. Under the provision relevant to the present case, the termination must occur within two years following the date on which control by the developer over the cooperative association is terminated. §3607(d). In the present case this date was October 30, 1985.

In the present litigation, Tenants Corp. argues that the 1987 termination related to both the 1981 garage lease between Associates and Parking and also the 1985 assignment from Associates to Tenants Corp. In its answer, Tenants Corp. states that it terminated a contract which it defines as a combination of the 1985 assignment and

the 1981 garage lease. In its initial memorandum of law submitted on the motions, Tenants Corp. relies on the combination approach by defining the garage lease as being the 1985 assignment. In its reply memorandum of law, Tenants Corp. plays a variation on the combination approach by arguing that it terminated "the total documentary package creating Tenants Corp.'s rights and obligations to Associates, as created by the Assignment and Assumption Agreement and the underlying leases." Finally, in its supplemental memorandum of law, Tenants Corp. argues that the 1981 garage lease was an unenforceable illusory agreement that did not have any legal effect until it "came into legal existence" through the 1985 assignment.

The problem with all this is that

the shareholders of Tenants Corp. only voted to terminate the 1981 garage lease. They did not vote to terminate the 1985 assignment, nor did they vote to terminate a combination of the lease and the assignment.

The essential question therefore is whether the shareholders of Tenants Corp. had a right to terminate the 1981 garage lease under §3607(a). The clear answer is that they did not. The lease was not entered into between the "unit owners or such [cooperative] association and the developer or an affiliate of the developer," within the meaning of §3607(a)(2). Nor was the garage lease entered into "while such [cooperative] association was controlled by the developer," within the meaning of §3607(a)(3). The 1981 garage lease was between the future developer of the cooperative,

Associates, and an affiliated corporation, Parking. But Parking was not, and never became, the cooperative association. No such association and no unit owners even existed in 1981, which was long before the cooperative plan became effective and over a year before Tenants Corp. was created.

None of the supplements to the lease was entered into between Associates and Tenants Corp. Each was between Associates and Parking. The date of the last supplement was three months before the cooperative plan became effective.

The reasoning in Brabert Realty Co. v. 20125 Owners Corp., 703 F.Supp. 314, 317 (S.D.N.Y. 1989), applies.

> Had the sponsor entered into the self-dealing leases prior to conversion, they would be immune to termination under the Act and appropriately so because the association would have clear prior notice that such premises were not part of the assets it was

> acquiring in the conversion. If, on the other hand, such self-dealing leases are made on behalf of the association after conversion by the sponsor acting through special developer control, this can deprive the association of assets on which its members may have reasonably relied on in the conversion process.

We must now return to the argument that what was terminated by the June 17, 1987 shareholders vote was actually the 1985 assignment or a combination of the 1985 assignment and the 1981 garage lease. Obviously Tenants Corp. wishes that it could somehow make use of the 1985 assignment in its efforts to terminate the 1981 garage lease, because the assignment was entered into between the sponsor and the cooperative association at a time when the former controlled the latter. But the plain fact is, as earlier stated, that the purported termination vote of June 1987 related solely to the 1981 garage lease. No vote was taken to terminate

the 1985 assignment by itself for in combination with the garage lease. Moreover, the time for talking any further action under §3607(a) expired two years following October 30, 1985 so that a vote regarding the assignment is no longer possible.

Tenants Corp. argues that the garage lease and the assignment are somehow one contract; that the vote of June 1987 was really a vote on this one contract; and since the 1985 assignment was involved, the termination was authorized by §3607(a). But there is no way that the garage lease and the assignment can be considered to be a single contract. They occurred four years apart. Each was entirely distinct in purpose and effect. The garage lease created a tenancy in which Associates was given the rights of a lessor and Parking was given the rights

of a lessee. The 1985 assignment had the effect of transferring Associates' rights as lessor over to Tenants Corp., while continuing Parking as the lessee. There is simply no basis in fact or law for the argument now made by Tenants Corp. that the garage lease and the assignment should be combined and treated as a single contract for purposes of applying §3607(a).

A further argument of Tenants Corp. is that the 1981 garage lease was an illusory agreement and did not "come into legal existence" until it was assigned to Tenants Corp. There is no merit whatever to this argument.

The position of Tenants Corp. in this case runs counter to both the terms of §3607(a) and its purpose. Congress gave tenants the right to terminate contracts between the sponsor and the cooperative corporation which

are made after the tenants have committed to purchase their apartments but before the corporation is free from the sponsor's control. In the present action, Associates entered into the garage lease with its affiliate Parking well before the cooperative conversion had begun and even before Tenants Corp. existed. The offering materials plainly disclosed and described the garage lease. Tenants Corp. and the prospective buyers of the apartments were fully apprised of this lease. The tenants who elected to purchase their apartments had the information necessary to calculate the effect of the garage lease on the value of their apartments. Similarly, Associates had the right to rely on the anticipated profit from the garage lease in working out the terms of the conversion.

An additional comment needs to be

made regarding the supplements to the 1981 garage lease. While the third and last supplement was entered into 3 months before the cooperative plan was declared effective on July 18, 1984, this supplement was made after the offering plan was accepted by the Attorney General and distributed to the tenants. This chronology of events might theoretically pose a problem if a tenant who had subscribed to purchase his apartment prior to the third supplement did not have the opportunity to rescind his subscription.

However, no such problem is presented in this case.. The law provides a mechanism to protect tenants in such a situation. Under New York statute, Associates was required to disclose any material changes in the offering materials and provide any early subscribers with the

opportunities to rescind. See N.Y. General Business law §352-e (McKinney 1984); N.Y. Comp. Codes R & Regs. tit. 13, §18.5(a)(5). In the second amendment to the cooperative offering plan, Associates disclosed its modification of the garage lease. Moreover, after the plan was declared effective, Associates informed the subscribers of their right to rescind.

CONCLUSION

The court grants plaintiffs' motion seeking a summary judgment declaring that the purported termination of the garage lese under 15 U.S.C. §3607(a) was of no effect. The court denies defendant Tenants Corp.'s motion for summary judgment.

SO ORDERED.

Dated: New York, New York
May 9, 1990

THOMAS P. GRIESA
U.S.D.J.

MANDATE

87-cv-5850
DOC #74 GRIESA

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT
------0-------

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 5th day of February, one thousand nine hundred and ninety-one.

Present: HON. JAMES L. OAKES,
Chief Judge
HON. J. EDWARD LUMBARD
HON. RALPH K. WINTER

Circuit Judges,

United States Court of Appeals
Filed
FEB 5 1991
Elaine B. Goldsmith, Clerk
Second Circuit

United States District Court
Filed
APR 3, 1991

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2 TUDOR CITY PLACE ASSOCIATES and
2 TUDOR CITY PARKING CORP.,

Plaintiffs-Appellees,

-against-

Docket
No.
90-7739

2 TUDOR CITY TENANTS CORP.,
KINNEY SYSTEMS, INC., and

AMERICAN SAVINGS BANK,

Defendants-Appellants.

DOCKETED AS
A JUDGMENT #91-0654
on 4/5/91

Appeal from the United States District Court for the Southern District of New York.

This cause came to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the judgment of said District Court be and it is hereby reversed and remanded to the said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellees.

A TRUE COPY
ELAINE B. GOLDSMITH
CLERK

Elaine B. Goldsmith, Clerk
BY:
Edward J. Guardaro,
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 21st day of March, one thousand nine hundred and ninety-one.

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2 TUDOR CITY PLACE ASSOCIATES
AND 2 TUDOR CITY GARDEN
PARKING CORP.,
Plaintiffs-Appellees,

-v-

Docket
Number
90-7739

2 TUDOR CITY TENANTS CORP.,
KINNEY SYSTEMS, INC. and
AMERICAN SAVINGS BANK,
Defendants-Appellants.

United States Court
of Appeals
Filed Mar 21 1991
Elaine B. Goldsmith
Clerk
Second Circuit

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Plaintiffs-Appellees 2 Tudor City Place.

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

90-1954 (2)

Supreme Court, U.S.
FILED
JUL 17 1991
OFFICE OF THE CLERK

No. 90-1953

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

2 TUDOR CITY PLACE ASSOCIATES AND
2 TUDOR GARDEN PARKING CORPORATION,

Petitioners,

– against –

2 TUDOR CITY TENANTS CORPORATION
KINNEY SYSTEMS, INC. AND
AMERICAN SAVINGS BANK,

Respondents.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT 2 TUDOR CITY TENANTS CORPORATION'S BRIEF IN OPPOSITION

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48

COUNTER STATEMENT OF THE QUESTIONS PRESENTED

1. Should this Court grant a writ of certiorari to review the decision of the Second Circuit Court of Appeals (which decision is in accordance with a prior seminal Second Circuit decision (West 14th Street Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188 (2d Cir. 1987), cert. denied, 484 U.S. 850 (1987) ("West 14th Street")) and numerous lower court decisions, holding that pursuant to the self-executing provisions of 15 U.S.C. §3607 ("§3607"), the garage lease at issue here was properly terminated, effective September 16, 1987?

2. Should this Court grant a writ of certiorari to review whether the holding of the Second Circuit Court of Appeals that the garage lease between the affiliate of the Sponsor (2 Tudor

City Parking Corp., "Parking Corp.") and the Cooperative Association (2 Tudor City Tenants Corp., "Tenants Corp."), pursuant to which the garage in the building (used by unit-owners who have a preference for garage spaces) is leased to the Sponsor's affiliate, who unilaterally controls and selects the garage operator, is a contract under §3607(a)(1) which "provides for operation, maintenance or management ... of property serving the ... unit owners"?

3. Should this court grant a writ of certiorari to determine whether §3607 should be amended judicially by interpretation, as petitioners' urge, to include a defense of "fairness," so that even where the criteria of §3607 are met, as here, the unit-owners should, nonetheless, be precluded from terminating a garage lease based on a

Sponsor's claim that it "is not fair" to terminate that garage lease, even when the garage lease was imposed by the Sponsor on the Cooperative Association for a term of 55 years (renewable "forever"), where the rents paid by the Sponsor's affiliate do not even cover total costs paid by the Cooperative Association's allocable to the garage (J.A. 956-957) and where the Sponsor at closing made a gross profit from the cooperative conversion of approximately $10,940,000, plus retained ownership of 124 occupied apartments?

4. Should this Court grant a writ of certiorari to review whether the application of §3607 violates the Fifth Amendment even though the garage lease was executed after the enactment of §3607, in accordance with a long line of Supreme Court cases holding that, "[l]aws and statutes in existence at the

time a contract is executed are considered a part of the contract, as though they were expressly incorporated therein" (Opinion A-15)?

List of Parties and Rule 28.1 List

The parties to the proceeding in the Court whose judgment is sought to be reviewed are set forth in the caption of the case to this Court.

Respondent 2 Tudor City Tenants Corp. ("Tenants Corp.") has no parent company, subsidiaries or affiliates to list pursuant to Rule 28.1.

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RESPONDENT 2 TUDOR CITY TENANTS CORP.'S BRIEF IN OPPOSITION TO THE PETITION FOR CERTIORARI

The respondent 2 Tudor City Tenants Corp. (previously defined as "Tenants Corp") respectfully requests that this Court deny the petition for the issuance of a writ of certiorari to review the Opinion of the United States Court of Appeals for the Second Circuit in this case reported at 924 F.2d 1247 (2d Cir. 1991).

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved, which are not part of the appendix to the petition are:

§3601: Congressional findings and purpose

a. The Congress finds and declares that:

1. there is a shortage of adequate and affordable housing throughout the Nation, especially

for low- and moderate-income and elderly and handicapped persons;

2. the number of conversions of rental housing to condominiums and cooperatives is accelerating, which in some communities may restrict the shelter options of low- and moderate-income and elderly and handicapped persons;

3. certain long-term leasing arrangements for recreation and other condominium- or cooperative-related facilities which have been used in the formation of cooperative and condominium projects may be unconstionable; in certain situations State governments are unable to provide appropriate relief; as a result of these leases, economic and social hardships may have been imposed upon cooperative and condominium owners, which may threaten the continued use and acceptability of these forms of ownership and interfere with the interstate sale of cooperatives and condominiums; apropriate relief from these abuses requires Federal action; and

4. there is a Federal involvement with the cooperative and condominium housing markets through the operation of Federal tax, housing, and community development laws, through the peration of federally chartered and insured financial institutions, and through other Federal activities; that the creation of many condominiums and cooperatives is undertaken by

entities operating on an interstate basis.

b. The purposes of this chapter are to seek to minimize the adverse impacts of condominium and cooperative conversions particularly on the housing opportunities of low- and moderate-income and elderly and handicapped persons, to assure fair and equitable principles are followed in the establishment of condominium and cooperative opportunities, and to provide appropriate relief where long-term leases of recreation and other cooperative- and condominium-related facilities are determined to be unconscionable.

§3603: Definitions

For the purpose of this chapter:

1. "affiliate of a developer" means any person who controls, is controlled by, or is under common control with a developer. A person "controls" a developer if the person:

a. is a general partner, officer, director, or employer of the developer,

b. directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interests of the developer,

c. Controls in any manner the election of a majority of the directors

of the developer, or

d. Has contributed more than 20 per centum of the capital of the developer. A person "is controlled by" a developer if the developer:

i) is a general partner, officer, director or employer of the person,

ii) directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interests of the person,

iii) controls in any manner the election of a majority of the directors, or

iv) has contributed more than 20 per centum of the capital of the person.

* * *

(22) "Special developer control" means any right arising under State law, cooperative or condominium instruments, the association's bylaws, charter or articles of association or incorporation, or power of attorney or similar agreement, through which the developer may control or direct the unit owners' association or its executive board. A developer's right to exercise the voting share allocated to any condominium or cooperative unit which he owns is not deemed a right of special

developer control if the voting share allocated to that condominium or cooperative unit is the same voting share as would be allocated to the same condominium or cooperative unit were that unit owned by any other unit owner at that time.

§3614: Waiver of rights as void

Any condition, stipulation, or provision binding any person to waive compliance with any provisions of this chapter shall be void.

COUNTER-STATEMENT OF THE CASE

In 1981, petitioner 2 Tudor City Place Associates ("Associates"), a partnership, purchased 2 Tudor City Place (the "Building") which consists of a 330 unit residential complex and parking garage. In the same month, Associates incorporated 2 Tudor City Garden Parking Corp. ("Parking Corp."); its officers and directors consisted of the principals of Associates. Associates leased the garage in the Building to its shell

corporation, Parking Corp., which in turn subleased the garage to Corrao, the then garage operator. Garage space was leased to residents and non-residents with residents having a first priority as to vacancies. (See Certificate of Occupancy, A-10). The 1981 lease between Associates and Parking Corp. provided that if ownership of the garage changed, the new owners would replace Associates as lessor if the new owner assumed the covenants of the lease.

Associates' plan was to convert the Building to cooperative ownership. In August 1982, the principals of Associates incorporated Tenants Corp. Associates caused Tenants Corp. to enter into a pre-conversion contract with Associates whereby Associates sold the Building and parking garage to Tenants Corp. and transferred to Tenants Corp. its lease with Parking Corp. Under that

contract, until Associates sold the majority of shares in Tenants Corp., it had the unlimited power to alter the terms of the garage lease.

On November 5, 1982, Associates filed a preliminary prospectus pursuant to the New York General Business Law §352(eeee) (McKinneys 1984). On November 16, 1983, an Offering Plan (similar to a securities registration statement) was issued to sell the shares to tenants-in-occupancy and the public.

The Offering Plan (consisting of over 607 pages and four pre-closing amendments) disclosed, buried in numerous parts, that Associates caused Tenants Corp. to lease the parking garage to Parking Corp, that Tenants Corp. was responsible for major repairs, that the term of the lease was April 30, 2040 with the right to extend and that

the rent to Tenants Corp. was then $340,000 annually.

The Offering Plan did not disclose the market value of the garage lease and that the rent Parking Corp. would pay to Tenants Corp. would be substantially below market. The Offering Plan did not describe that Parking Corp. under the Kinney sublease would collect at a minimum $775,000 annually. The Offering Plan did not disclose that the garage rent to be paid would not even cover Tenants Corp.'s expenses allocable to garage operations. The Offering Plan misrepresented that "present and future rent payable by the tenant [Parking Corp.] is sufficient to cover to expenses fairly attributable to the garage space" (J-A 353, 512).

Associates caused two closings to be held, one on July 24, 1985, at which 106 out of 353 units were sold, and a second

closing on October 1, 1985, when 103 of the remaining units were sold. On July 24, 1985, the first closing, Associates caused Tenants Corp. to execute an Assignment and Assumption Agreement, whereby the rights and duties of Associates as landlord of the garage lease were transferred to Tenants Corp.

As the Second Circuit Court of Appeals noted:

> There is only one garage lease relevant to this case. That lease was originally executed by Associates, as lessor, and its related shell corporation, Parking. After the 1985 assignment and assumption, Tenants came to stand in Associates' place as lessor of the garage to Parking (A-6).

Based on a calculation of figures set forth in the Offering Plan, in July 1985, Associates' gross profit from this conversion was $10,940,000 plus the ownership of 124 apartments.[1/]

On October 30, 1985, an independent Board of Directors of Tenants Corp. was elected. On June 17, 1987, more than two-thirds of the unit owners voted to terminate the garage lease, pursuant to §3607. Notice of termination was sent to Associates and Parking Corp. providing that the Garage Lease was terminated effective September 16, 1987.

On August 13, 1987, Associates and Parking Corp. brought this action claiming that Tenants Corp.'s unit-

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1/ After the conversion was completed, Associates borrowed from American Savings Bank in excess of $3 Million with its unsold shares as security for the loan. Associates did not pay back its loan, and the lender foreclosed on its security. Associates, based on our information, has no further liability to the lender. Accordingly, its gross profit (conversion proceeds plus loan proceeds) was in excess of $13,940,000.

owners had no right to terminate the garage lease under §3607.

Upon cross-motion for summary judgment, Judge Griesa, United States District Court, Southern District of New York (A-17-39) granted petitioners' motion as to the §3607 claim and denied Tenants Corp.'s motion. The District Court granted Tenants Corp.'s motion for certification to the Second Circuit Court of Appeals under Fed. R. Civ. P. 54(b).

The Second Circuit Court of Appeals unanimously reversed the District Court, finding:

a. The garage lease was properly terminated effective September 16, 1987 (A-12, 13);

b. The statutory criteria of §3607 were properly met (A-8-10);

i. §3607 applies to this garage lease; a lease is a species of contract (A-9, 10);

ii. The Parking Garage " ... was property of the cooperative unit-owners" (A-10, 11);

iii. The contract was between Tenants Corp. and an affiliate of the Sponsor (A-10, 11);

iv. Tenants Corp. became a party to the contract on July 24, 1985 when it assigned the garage lease; on that date, Tenants Corp. was under "special developer control" since an independent Board of Directors was only

elected on October 30, 1985 (A-11);

v. The contract was for a term of more than three years (A-11);

vi. The contract termination was timely and within two years of the end of "Special Developer Control" (A-13).

c. The Second Circuit held that §3607 "facially is devoid of any disclosure defense," rejecting petitioners' contention in this regard (A-14). In addition, the Second Circuit Court of Appeals found that the purported disclosures buried in a 607 page Offering Plan were incomplete in that "they did not disclose the

disparity between the garage's market value and the rent Parking Corp. was to pay Tenants Corp. (A-14).

d. The Act does not violate the takings clause of the Fifth Amendment since the garage lease was executed after the Act was enacted (A-15).

1. Legislative Background

In 1980, Congress enacted the Federal Cooperative and Condominium Abuse Relief and Protection Act, 15 U.S.C. §3601, et. seq. ("the Abuse Relief Act"). The purpose of §3607 of the Abuse Relief Act was to provide tenant-shareholders with a method to terminate certain post-conversion sweetheart leases (as defined in that statute). The method provided was a

vote by unit owners to terminate such leases, followed by a notice of termination effective ninety days hence. Congress intended that process to be self-executing, without the need for judicial intervention -- and that is exactly what happened at 2 Tudor City Place; the unit-owners voted to terminate the garage lease between Tenants Corp. and Parking Corp. The Second Circuit Court of Appeals unanimously found that the garage lease was properly terminated under §3607.

By enacting §3607, Congress put all cooperative and condominium converters on notice that sweetheart leases may be subject to termination. After 1980, Associates, the sponsor here, had no reasonable expectation for future garage revenue in that §3607 was in full force and effect and unit-owners could exercise their Congressionally mandated

right to terminate the garage lease according to the procedures of §3607.

In enacting the Abuse Relief Act, Congress was cognizant that the imposition of long-term leases between the new cooperative or condominium entity and an affiliate of the Sponsor was a common practice in conversions.

Section 3601 of the Abuse Relief Act sets forth the Congressional findings and purpose behind the Abuse Relief Act, including an explicit finding that certain long-term leasing arrangements:

> which have been used in the formulation of cooperative and condominium projects may be unconscionable...as a result of these leases, economic and hardships may have been imposed upon cooperative and condominium owners, which may threaten the continued use and acceptability of these forms of ownership (15 U.S.C. §3601).

Congress intended that the §3607 termination be effective without resort to the judicial process. Senator

Williams, sponsor of the bill, stated:

> I am pleased to note that the Congress did retain a provision of the Senate bill which provides a federally-sanctioned, simple and non-judicial method by which the residents of a conversion project may void a long-term self-dealing leasing arrangement (S. Congressional Record -- Senate 13948 (September 30, 1980)).

Section 3607 of the Abuse Relief Act "provides a means by which the unit-owners of a conversion project may terminate a long-term, self-dealing contractual arrangement without having to resort to judicial action." S. Rep. No. 96-736, at 51.

The Abuse Relief Act contains two provisions relating to the long-term leasing practices; §§3607 and 3608. The self-executing procedures of §3607 apply to leases "entered into on or after October 8, 1980" (§3607(a)), the effective date of the Abuse Relief

Act. Those leases are subject to the self-executing procedure of §3607. §3608 applies to leases entered into prior to June 4, 1975, and provides a judicial method for providing remedial relief. The difference between the self-executing nature of §3607 and the judicial method set forth in §3608 reflects Congress's concern with applying the self-executing procedures set forth in §3607 retroactively to leases entered into prior to the enactment of the Abuse Relief Act.

§3607 of the Abuse Relief Act is in the nature of a consumer protection statute. The terms of the lease between Tenants Corp. and Parking Corp. are among the worst of its kind. The Garage Lease here is for a term of fifty-five years (renewable as long as the ground lease continues), the rent does not cover expenses such as real estate taxes

-- all expenses are borne by Tenants Corp. On the other hand, the Sponsor's affiliate reaps over $17 million of profit over the term of the lease (assuming rents at the level of the Kinney sub-lease) and performs no services.

In West 14th Street, the Second Circuit Court of Appeals noted, particularly, the problem of "hidden costs":

> Congress' desire to protect cooperative apartment owners in that it prevents the developers from offering the tenants a deceptively low purchase price financed by hidden costs spread over a number of years. Congress may have determined that even with effective representation in negotiations, tenants may still be unduly tempted by an artificially low insider purchase price to accepting hidden future costs. There may also have been concern that non-tenant buyers without representation by a tenants' organization might not be informed of concealed costs. (815 F.2d at 201)

Congress recognized that in the absense of federal legislation, there was no effective legal means for the cooperative and its unit-owners to remove the yoke of such long-term leases.[2/] The primary purpose of this legislation was to protect the unit-owners by a simple, self-executing remedy, based on objective criteria, which could easily and readily be understood and applied by lay persons, and which did not need judicial intervention for implementation.

2/ Cooperatives have attempted to rid themselves of such leases under various theories ranging from unconscionability to illegal tying arrangements under the antitrust laws. To the best of our knowledge to date, no such case has been successful. 305 East 24th Street Owners Corp. v. Parman, 714 F.Supp. 1296 (S.D.N.Y. 1989).

REASONS CERTIORARI SHOULD BE DENIED

Despite petitioner's efforts to create the illusion of unresolved issues, this case does not raise any issue appropriate for review by this Court.

First, the provisions of the Abuse Relief Act are clear on its face; the Second Circuit Court of Appeals has properly applied the statute to the facts here. §3607, the operative section, is written in simple and clear English, readily understandable. The Abuse Relief Act, and particularly §3607, has been twice interpreted by the Second Circuit Court of Appeals (West 14th Street and this case) -- the holdings sustain the right of unit-owners to terminate under §3607 a garage lease imposed by the Sponsor, such as the garage lease here. Numerous Southern District of New York decisions

and decisions by the New York State Appellate Division (the highest New York State Court to address this issue) are in accord.

This Court previously denied certiorari in West 14th Street, 484 U.S. 850 (1987). The petition for certiorari in West 14th Street raised many of the very same issues as are being alleged in this petition, including an argument similar to that made by petitioner that some of the provisions of §3608, which apply only to pre-1975 leases, should be grafted onto §3607.

Second, the Second Circuit decision in this case properly reflects and is in accord with the lower court decisions and implements the congressional purpose to protect unit-owners from the economic consequences of self-dealing leases.

Third, no constitutional issue is presented. Associates, the Sponsor,

bought the building after §3607 of the Abuse Relief Act was enacted; the garage lease between the Sponsor and its affiliate was executed a year after §3607 was enacted.

The Sponsor seeks review by this Court because the Sponsor simply does not like §3607 and the rights Congress afforded thereunder to unit-owners. All these issues raised in the petition have been categorically and properly rejected by the Second Circuit Court of Appeals and there is no reason for further review by this court.

2. §3607 is Clear and Understandable on its Face

The petition repeatedly refers to §3607 as "inept," "inartfully drafted," "incomprehensible" and "unfair," which is just not the case. The statute sets forth -- step by step -- the process by

which unit-owners may terminate leases such as the garage lease here. The definitional section of the Abuse Relief Act, §3603, which petitioners failed to set forth in their petition, defines the critical terms.

Petitioners' real complaint is that they do not like the Abuse Relief Act and the right granted to unit-owners to terminate the garage lease. However, Congress legislated this remedy to protect unit-owners from the financial impact of such leases.

In difficult economic times, as now, real estate taxes and fuel expenses rise, while unit-owners' personal income declines. The ability of unit-owners to meet maintenance increases (as well as to pay their own cooperative loans) is limited, especially when a portion of maintenance fees must be used to subsidize the Sponsor's profit under the

garage lease. Congress was rightfully concerned that these long-term leases would impose financial burdens on future unit-owners, which could jeopardize the ownership of their homes, and therefore, provided the termination remedy of §3607.

There is not a shred of evidence to support Petitioners' "statement" that because of the Tenants Corp./Parking Corp. Lease, the prices for the apartments were lower. The Offering Plan was silent in that regard. Petitioners' self-serving statements are pure speculation. Indeed, the price per share was the same from Black Book to Closing, but the terms of the garage lease became more favorable to the Sponsor. Moreover, many of the unit-owners who are now carrying the financial burden of this lease did not buy their apartments from the Sponsor.

but bought them from other tenants-shareholders at open market prices and did not receive this alleged benefit.

As the Second Circuit Court of Appeals so aptly noted:

> . . . it is unrealistic to expect prospective homeowners to understand all the financial data revealed in the offering materials. The average cooperative buyer is vulnerable to the practices of developers who may bury the hidden costs of self-dealing contracts in lengthy, legally-mandated disclosure documents. Indeed, in this case, Associates, disclosed the rent and long-term nature of the lease in the midst of its 607 Offering Plan. Yet, it did not disclose the disparity between the garage's market value and the rent Parking was to pay Tenants. The Offering Plan merely stated that 'Associates expected, to make a profit with respect to the Garage Lease in the future.' Only a legal or real estate expert could discern the possible extent of such profit. The amount of this profit would not become known to the typical purchaser of Tenants shares until Associates relinquished control of Tenants, and an independent

> board of directors was elected (A-14).

Congress recognized that during the conversion process, the Sponsor had the ability to establish an affiliate (as defined in §3603(1)) and impose on the cooperative a lease with that affiliate. The Sponsor's ability to impose such a lease is self-dealing in the most elementary sense. Frankly, petitioners' argument that this practice does not fall within §3607 is incomprehensible. According to petitioners, §3607 only applies when there is "divided control" and not when the sponsor has complete control. Control is control, whether it is 100% control or 51% control. As stated by the Second Circuit:

> Pre-conversion leases and contracts executed by the developer and its affiliates, such as tenant cooperatives with yet unsold shares, are self-dealing agreements. The

> developer stands on both sides of the bargaining table because it still controls its affiliate. Because the developer controls all parties at the pre-conversion stage, it can, as Associates did, enter into a self-dealing contract with an affiliate and then transfer its contractual obligations to a cooperative association (A-7).

Petitioners' repeated slurs -- calling Tenants Corp. and its unit-owners "unscrupulous" -- are unwarranted and are simply endemic of petitioners' desperation. Tenants Corp. and its unit-owners were exercising their Congressional given rights.

Similarly, petitioners' plea for the sympathy from the Court rings hollow. Petitioners could not have any reasonable basis to expect future garage revenues. From the date petitioners purchased the Building in 1981, §3607 was in full force and effect, and there was no rational basis for petitioners to

expect the continuation of those revenues in perpetuity.

Moreover, petitioners' purported reliance was at Tenants Corp.'s expense. Petitioners did not "keep" the ownership of the garage with all accompanying expenses. Here, Parking Corp. does not pay expenses such as real estate taxes; that burden and all other expenses are paid by the over 300 unit-owners of Tenants Corp., and are not fully covered by the amount of Parking Corp.'s rent payments.

Future garage revenues were only one aspect of petitioners' total profit picture. Based on the Offering Plan disclosures (J-A 107), the Sponsor's gross profits by July 1985 were approximately $10,940,000, plus the ownership of 124 occupied apartments. Subsequent gross profits were at a minimal an additional $3 million, for

total gross profits of $13,940,000. Certainly, the conversion was highly profitable -- even without the garage lease.

3. §3607 has been consistently interpreted by the Second Circuit, the Southern District of New York and New York State Courts

The two Second Circuit decisions (West 14th Street and 2 Tudor City) interpreted §3607 in accord with and to further the Congressional purpose to protect unit-owners. The Second Circuit both in this case and in the West 14th Street case has consistently applied §3607 to afford unit-owners with the self-executing right to terminate leases, such as the garage lease here. In the West 14th Street case, the Sponsor sought certiorari -- raising very similar issues to those being

raised here -- and this Court denied that petition for certiorari.

The Second Circuit's decision in West 14th Street that a lease is a contract -- which petitioners object to strongly -- is correct. As the Second Circuit Court of Appeals held in 2 Tudor City:

> There is no merit to this contention [that §3607 applies only to contracts, and a lease is not a contract]. Nothing in the extensive legislative history of the Act suggests that Congress meant to exclude leases from the term "contract" (A-8).

The lease was a contract which provided for the

> operation, maintenance and management of a garage which serv[ed] the . . . cooperative unit owners. 15 U.S.C. §3607(a)(1). As we recently held in West 14th Steet, §3607 covers leases as a species of "contract." 815 F.2d at 197-98.[3]

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[3] As noted in the West 14th Street (footnote continued)

In the three years since this Court's decision, numerous courts in this district have followed the West 14th Street decision and upheld §3607 terminations. A reversal would create havoc as to the orders issued in those cases.

The District Court decisions, many of which are unreported, are to our knowledge set forth below:

(1) 305 East 24th Street Owners Corp. v. Parman, 85 Civ. 388 (RW) (S.D.N.Y. 1987).

(2) 520 East 72nd Commercial Corp. v. 520 East 72nd Owners Corp., 691 F.Supp. 728 (S.D.N.Y. 1988).

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case:

> [A] line drawn between leases and contracts would exalt form over substance. Leases, a species of contract, may contain covenants tha require the lessee to perform certa contractual services for the landl

815 F.2d at 198.

(3) 181 East 73rd Street v. 181 East 73rd Street Tenants Corp., 87 Civ. 3362 (RO) (S.D.N.Y. 1988).

(4) Brabert Realty Co. v. 20125 Owners Corp., 703 F.Supp. 314 (S.D.N.Y. 1989).

(5) King v. 415 Second Owners Corp., 86 Civ. 4800 (MBM) (S.D.N.Y. 1987).

(6) Cromwell Associates v. Oliver Cromwell Owners, Inc., 705 F.Supp. 116 (S.D.N.Y. 1988).

(7) Coliseum Park Apartment Co. v. Coliseum Tenants Corp., 742 F.Supp. 128 (S.D.N.Y. 1990).

(8) 200 East 84th Street Owners Corp. v. Salomone, 89 Civ. 5035 (S.D.N.Y. 1989).

(9) Park South Tenants Corp. v. 200 Central Park South, 748 F.Supp. 208 (S.D.N.Y. 1990)

(10) Park South Tenants Corp. v. 200 Central Park South, 754 F.Supp. 352 (S.D.N.Y. 1991)

Several New York cases are in accord with and follow the federal decisions:

(1) Phoenix Tenants Ass'n. v. 6465 Realty Co., 500 N.Y.S.2d 657 (1st Dept. 1986), requiring sponsors to disclose to tenants their rights under §3607.

(2) 233 East 86th Street Corp. v. Park East Apartments, Inc., 131 Misc.2d 242, 499 N.Y.S.2d 853 (N.Y.Co. 1986).

Only one New York City landlord-tenant judge in dicta has stated that he would not follow the Second Circuit's holding in West 14th Street that a lease was a contract, although he would and did follow the West 14th Street case to hold that §3607 does not apply to a commercial lease. Park East Apartments, Inc. v. 233 East 86th Street Corp., 139 Misc.2d 806, 529 N.Y.S.2d 674 (Civil Ct. Cty. of New York, 1988), affd., on other grounds, 143 Misc.2d 60 (App. Term, 1st Dept. 1989). Petitioners ask this Court to grant certiorari because the reasoning of that landlord-tenant judge "is correct," but that the Second Circuit Court of Appeals in its two decisions and various District Court decisions were "incorrect," and that

those Circuit Court and District Court judges do not understand §3607. There is no reason for this Court to review the holdings of the Second Circuit. The intellect and clarity of those holdings speak for themselves. There is no conflict between the federal decisions and the New York State decision -- even the holding of the landlord-tenant judge comports with the West 14th Street holding.

4. §3607 is constitutional

§3607 only applies to leases executed after the enactment of the Abuse Relief Act in 1980. Thus, it cannot interfere with any investment backed expectations because those expectations necessarily included the possibility of unilateral early termination by the unit-owners pursuant to the Abuse Relief Act. See Penn Central Transportation Co. v. City of

New York, 438 U.S. 104 (1978). See also S&D Service Inc. v. 915-925 West Schubert Condominium Association, 132 Ill. App.3d 1019, 478 N.E.2d 478 (2d Div. 1985). Based on the rights afforded to the unit-owners by §3607, contrary to petitioners' contentions, the unit-owners did not "understand" that the anticipated profit "belonged" to petitioners. To the contrary, the unit-owners "understood" that §3607 permitted the termination of the lease; petitioners similiarly understood that the lease was subject to the possibility of termination.

Petitioners had the ability to structure the conversion to avoid §3607. See Colonial Penn Insurance Co. v. Heckler, 721 F.2d 431 (3rd Cir. 1983) where the Third Circuit did not find a regulation that affected pre-existing contracts unconstitutional because,

among other things, the company knew of the imminent congressional action "well in advance" of the effective date of the regulations and, thus, had time to make the necessary adjustments. For example, Associates could have entered into a lease with a non-affiliate, and avoid the application of §3607.

Nor is there a due process violation. Where a contract comes into existence after the effective date of the statute, there is no entitlement to those rights previously limited by statute, and thus, procedural due process is not implicated.[4/] See Board

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[4/] Notwithstanding petitioners' lack of entitlement to notice, they, in fact, did receive notice of the meeting where the vote to terminate the garage lease was presented. Indeed, Mr. Nathan Dershowitz, petitioners' counsel and a tenant-shareholder of Tenants Corp., not only attended the meeting, but presented arguments against the vote to terminate.

of Regents of State Colleges v. Roth, 408 U.S. 564 (1972); reh. den., 439 U.S. 883 (1978). These constitutional issues have been resolved specifically with regard to §3607 in the decision below (A-15). See also, West 14th Street; supra, 305 East 24th Street Owners Corp. v. Parman, 85 Civ. 388 (RJW) (S.D.N.Y., April 28, 1987).

CONCLUSION

No serious question warranting review by this Court has been presented. The mere fact that petitioners do not like the effect of §3607 does not warrant review by this Court. Congress has determined to legislate cooperative conversions and to protect unit-owners from such onerous leases as the garage lease here. The Second Circuit Court of Appeals followed the Congressional mandate and properly-

interpreted §3607, and applied it to the facts herein in accordance with the language of the statute and existing case law.

Respectfully submitted,

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July 16, 1991

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90-1954

Supreme Court, U.S.
FILED
JUL 30 1991
OFFICE OF THE CLERK

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

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2 TUDOR CITY
PLACE ASSOCIATES
and 2 TUDOR GARDEN
PARKING CORPORATION,

Petitioners,

-against-

2 TUDOR CITY
TENANTS CORPORATION,
KINNEY SYSTEMS, INC. and
AMERICAN SAVINGS BANK,

Respondent.

PETITIONER'S REPLY TO THE BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

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ARGUMENT

This case presents an issue of statutory construction with both practical and theoretical importance. At the practical level, the success or failure of condominium and cooperative conversions may depend on whether tenant organizations are allowed to terminate, without cause, certain economically desirable and above board leases under the Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §3601 et seq. (the "Act"). Theoretically, the case raises the issue of how a federal court should interpret a federal statute that governs an area that Congress itself believed should be regulated largely by the states. The Second Circuit twisted the language of the Act in order to expand the scope of its coverage.

Granting certiorari in this case, therefore, provides this Court with a perfect vehicle to develop principles for interpreting imprecisely drafted federal statutes intended to preserve the dominant state regulatory role.

Petitioners 2 Tudor City Place Associates ("Associates") and 2 Tudor Garden Parking Corp. ("Parking") submit this Reply Brief for two purposes. First, to redirect the Court to the important issues of statutory construction unfairly obscured in the Brief in Opposition of respondent 2 Tudor City Tenants Corp. ("Tenants"), and, second, to show the irrelevance to those issues of the factual controversies injected by Tenants in its Brief.

Tenants has carefully constructed its Brief in Opposition to create the false impression that it is composed of

weak and gullible unit holders who have been fooled by petitioners' machinations. But this is not a case that involves unsophisticated tenants at the mercy of skilled and unscrupulous developers. Respondent was at all times represented by sophisticated counsel who took advantage of the extensive legal protection provided to tenants in conversion projects, and who bargained hard to obtain the best possible deal for themselves under the relevant substantive law.

This case, therefore, does not involve tenant-victims of economic exploitation, but rather a strained and contrived judicial interpretation of the Condominium and Cooperative Abuse Relief Act that has allowed a sophisticated tenants group to reap an enormous economic windfall without any

statutory or economic justification.

I. RESPONDENT HAS FAILED TO ADDRESS ANY OF THE LEGAL ISSUES RAISED IN THE PETITION FOR CERTIORARI

Tenants utterly fails to confront the internal difficulties with the Condominium and Cooperative Abuse Relief Act, its legislative history, and its unsound interpretation in the Second Circuit. To read Tenants' account of the Act, one would think that section 3607, the subject of this litigation, was the centerpiece of the Act, and that section 3608, which dealt with setting aside unconscionable leases entered into before June 4, 1975, was a casual afterthought. Both the Act itself and its legislative history belie that interpretation.

Section 3608, which sets out elaborate tests to determine when unconscionable leases may be set aside, was subject to extensive debate and

compromise between the Senate, which wanted tougher controls, and the House of Representatives, which wanted to leave this matter largely in the hands of the states. The great anomaly of the Act is that the legislative history contains virtually no discussion of section 3607, even though it provided tenants with a future self-help remedy that was far more intrusive into state law. Congress never indicated why this extraordinary relief was needed or how it would work in individual cases.

When Congress intends to confer on any group of persons the power to unilaterally terminate a contractual arrangement, it should surely give clear notice of the set of transactions covered so that interested and informed parties can steer clear of any statutory trapdoor. Yet here Congress gave neither clue as to why this

extraordinary remedy was needed nor any indication of the remedy's scope. The Second Circuit's construction of the Act to cover leases for garage space upset virtually everyone's initial and legitimate expectations of the Act's reach.

Owing to the Congressional uneasiness and uncertainty about the scope of the Act, the Second Circuit should have exercised judicial prudence in construing section 3607, and not have stretched the language of the Act to nullify commercially useful and above-board transactions. But as our Petition for Certiorari demonstrates, the Second Circuit made two unwarranted leaps.

First, the Second Circuit assumed that, in general, all leases were contracts covered by section 3607, and, in particular, that this Garage Lease

was a contract for the "operation, maintenance, or management" of property serving the cooperative, even though this Garage Lease imposed no service obligations on Parking, as tenant, but allowed it to either leave the space unoccupied or use it for any other purpose, so long as it paid the rent stipulated in the Lease.

More importantly, the Second Circuit misconstrued section 3607 to cover transactions that did not involve "self-dealing." Although Tenants profess to find petitioners' arguments about the reach of section 3607 "incomprehensible" (Respondents Brief at page 27), it offers no reason why those arguments are incorrect. Instead, Tenants takes an irresponsible, know-nothing approach to section 3607, asserting that "control is control, whether it is 100% or 51%."

(Respondent's Brief at 27) That is wrong on every count.

The importance of divided control, while derided by Tenants, is explicitly recognized in section 3607, which is officially titled, "Termination of Self-Dealing Contracts." "Self-dealing," as ordinarily understood, can only occur when the same party is on both sides of the transaction in unequal proportions. Some other party must have an interest at risk on one side of the transaction in order for self-dealing to occur. Self-dealing cannot occur when the same persons are in 100 percent control of both sides of the deal. The Second Circuit was simply wrong to describe any pre-conversion contract or lease as a self-dealing arrangement (A-7), even in the absence of divided control.

Congress plainly intended this

ordinary sense of self-dealing to control. Section 3607(c) makes it clear that only those contracts entered into "while" the developer had "special developer control," or a majority of the votes of the association, are covered by section 3607. The definition of "special developer control" in section 3603(22), which elaborates on which shares count toward the developer's control, only makes sense in the context of divided ownership. There is no "special developer control" when the developer owns all the shares; no one cares how power is allocated between shares when all are owned by the same person.

When the Second Circuit erroneously paraphrased section 3607(c) to say that it allowed tenants to set aside any transaction entered into "prior to the time" tenants took over

the control of the cooperative board, it read the self-dealing requirements out of the Act. In the absence of clear indication to the contrary, the Second Circuit should have adhered to the ordinary meaning of self-dealing and limited the potential reach of section 3607's extraordinary remedial provision. By extending that reach, the Second Circuit has ignored Congress' intent and committed a major blunder of statutory construction that this Court should correct.

II. RESPONDENT HAS INJECTED INTO ITS STATEMENT MISLEADING AND IRRELEVANT FACTS THAT DEFLECT THIS COURT FROM THE IMPORTANT LEGAL ISSUES RAISED IN THIS CASE

A. The Present Suit Involves No Issue Of Misrepresentation or Nondisclosure

Throughout it brief, Tenants repeatedly refers to alleged failures to disclose pertinent information about

the Garage Lease in the conversion offering materials. But this case does not involve fraud, misrepresentation, concealment, nondisclosure or violation of the blue sky or federal securities law. Tenants, like anyone else, might have elected to bring an action for any of these forms of wrongful conduct under either state or federal law. But then it would have had to prove the falsity of the statements made, their materiality, and their causal connection to any relevant loss. As even Tenants recognizes, it is most unlikely that it would prevail, given the courts' unwillingness to upset similar leases without recourse to section 3607 of the Act. (Respondent's Brief, p.21, n.2)

In any event, Tenants' entirely unsupported allegations of nondisclosure and misrepresentation are

wholly beside the point. Under the Act as the Second Circuit has read it, Tenants could set aside the Garage Lease even if the unit holders had perfect knowledge of its terms and conditions, and had solemnly agreed to abide by all of them. Indeed, that is precisely the holding of West 14th Street Commercial Corp. v. 5 West 14th Street Owners Corp., 815 F.2d 188 (2d Cir. 1987), cert. denied, 484 U.S. 850 (1987), which allowed tenants to set aside a lease, even though its terms had been the subject of exhaustive negotiations.

The only question presented by this case is whether the naked power granted to Tenants under the Act extended to the Garage Lease entered in well before the conversion process began.

B. The Present Suit Involves No Issue Of Excessive Rate Of Return

Tenants also claims, as if it were proven facts, that Associates made a profit on the conversion even without the Garage Lease, that prices for individual units were not lowered to reflect the anticipated profits of that lease, and that 124 units in the original offering constituted an economic asset left out of petitioners' accounting. These issues, too, are irrelevant to the present suit, which does not involve any form of rate of return regulation on the developer.

Moreover, even if Associates did derive profit from the conversion deal apart from the Garage Lease -- which petitioners would vigorously contest in any proceeding in which it were relevant -- Tenants still has offered no reason why it should be able to grab those profits for itself. Under the

Second Circuit's interpretation, Tenants could unilaterally set aside the Garage Lease even if it plunged Associates into instant bankruptcy.

C. The Present Suit Involves No Issue Of Hardship Relief For Tenants

Tenants also complains that in "difficult" economic times it is hard for tenants to meet rising expenses on limited incomes. (Respondent's Brief, at 24) But bad times and rising costs afflict landlords as well as tenants, and so long as tenants reap the benefits of prudent purchases in boom times, they should not be allowed to undo in whole or in part purchases that they regret in hard times. Moreover, under the Second Circuit's reading of the Act, Tenants could unilaterally set aside the Garage Lease even if there had been an enormous escalation in the price of the units and a sharp decrease in the cost of maintenance and taxes.

D. The Present Suit Involves No Distinction Between Tenants Who Purchased From Associates and Those Who Purchased From Prior Unit Holders

Finally, it is wholly irrelevant that some tenants did not purchase their units from Associates, but from other unit holders. (Respondent's Brief at 25-26) If subsequent purchasers have any grievances, they should be directed toward the sellers of their respective units, not toward Associates.

When all these irrelevancies are put into perspective, its is clear that Tenants has not demonstrated that there are any factual issues that argue against review or that should predispose this Court to award Tenants dispensation from the ordinary rules of commercial transactions or statutory construction. The long list of District Court cases cited by Tenants as following the Second Circuit

(Respondent's Brief 32-34) is not testimony to the wisdom of the Second Circuit's decisions, but only to the binding power of those decisions on the District Courts within the Circuit.

The Second Circuit has vastly expanded a statute that Congress plainly intended to have a narrow scope. The important issue before this Court is whether the federal courts should have the power to construe statutes in complete disregard of Congressional intent and in violation of well established principles of statutory construction solely to achieve a result that the court, but not Congress, deems appropriate.

CONCLUSION

For the reasons stated in Petitioners' original Petition, the Writ of Certiorari should be granted to correct serious mistakes in the construction of section 3607 of the Condominium and Cooperative Abuse Relief Act.

Respectfully submitted,

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Dated: July 29, 1991
Chicago, Illinois